Economic and market update

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Bob reviews events in Australian and overseas markets during July.

How did markets perform in July?

July featured surprisingly strong global share gains. This was supported by better than expected US corporate profit reports and global economic data.

US shares achieved a solid 3.6% gain in July given improved US economic activity, the US Federal Reserve's (Fed's) steady interest rate policy and better than expected corporate profit results. European shares recorded similar gains with hopes for more stimulus from the European Central Bank.

The UK share market surprised on the upside despite poor business and consumer confidence. UK shares are drawing support from a weaker currency and expectations for interest rate cuts from the Bank of England.

Japan's share market surged by 6.4% in July given hope from both budget and monetary stimulus. This comes after the sharp decline of nearly 10% in June.

Australian shares rose by a robust 6.3% in July. This was an impressive performance considering the uncertainty created by the close Federal election result. Higher coal and iron ore prices helped the commodity market. Real Estate Investment Trusts, consumer and infrastructure stocks were favoured following the low June quarter inflation result which raised the probability of the Reserve Bank of Australia (RBA) cutting interest rates.

Global bond yields drifted sideways in July. The Fed's steady interest rate stance in July and the potential for further interest rate cuts in Europe kept bond yields low. UK bond yields reached historic lows given weak business and consumer confidence results were seen as increasing the probability of interest rate cuts.

The Australian dollar (AUD) appreciated given the stronger performance of key commodity prices. The Fed's continued delay in raising US interest rates as well as the prospect of further European monetary stimulus also helped the AUD to strengthen.

What were the key factors driving markets?

In the US, economic activity data was on balance better in July. Economic growth did disappoint in the June quarter with annualised growth at only 1.2% compared to the expected 2.6%. More encouraging was the strong June employment result, robust retail sales and encouraging housing sales data. While the Fed kept interest rates steady at July's policy meeting, price pressures continue to build with core inflation running at a 2.3% annual pace in June. Hence the case for higher US interest rates is progressively strengthening.

China's economic activity data was solid in July. China's annual economic growth for the June quarter was 6.7% which matched the March quarter. China's industrial production maintained a steady 6% annual growth pace while retail sales were robust at 10% growth.

Japan's economic activity data was marginally better and its manufacturing sector has seen confidence edge higher. While Japan's unemployment rate has fallen to 3.1%, the lowest level since 1995, inflation remains weak and there is significant pressure for both budget and monetary stimulus to raise Japan's inflation.

Emerging markets provided mixed signals. Turkey's attempted military coup on 15 July heightened political concerns, however the rapid restoration of Turkey's political leadership and the central bank cutting interest rates calmed financial markets. Brazil's economy remains in recession with retail sales weakening ahead of the Olympic Games and inflation remains high at 8.8%. In India, a manufacturing business survey shows more promising signs while annual inflation is stable at 5.8%.

Australia recorded solid economic activity data. Australia's labour market achieved moderate jobs growth for June and the National Australia Bank business survey showed encouraging gains for confidence and conditions. However the June quarter's annual inflation was just 1%, well below the RBA's 2% to 3% target range. This contributed to the RBA cutting the official cash interest rate from 1.75% to a new historic low of 1.50% on 2 August.