

# Economic and market update

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*Bob reviews events in Australian and overseas markets during October.*

## How did markets perform in October?

Global shares were softer in October (hedged -0.5%, unhedged -1.1%). Concerns over the prospect for higher US interest rates and higher global government bond yields kept global shares under pressure.

US shares drifted lower in October by 1.9%. US economic activity was solid with encouraging job gains, positive business surveys and strong consumer spending. This solid economic activity has “strengthened” the case for the US Federal Reserve (Fed) to raise US interest rates by year end. Risk appetites have also moderated ahead of November’s US Presidential election.

In Europe, economic activity was modest and European shares fell by 2.6%. This led to financial market and media commentary suggesting that the European Central Bank (ECB) may reduce their asset purchases program next year.

Japan’s share market surged in October, benefitting from a weaker yen against the US dollar (USD).

Australian shares disappointed in October with a 2.2% fall. Interest rate sensitive sectors such as Health Care (-8.3%) and Australian Real Estate Investment Trusts (-7.9%) were adversely impacted by rising Australian bond yields and global factors. Resources were more resilient (1.2%) given higher coal and iron ore prices.

Global bonds yields moved sharply higher in October with concerns over the pending US interest rate rise and doubts whether the ECB will continue their asset purchase program. In Australia, government bonds yields moved sharply higher in response to both domestic and global factors.

The Australian dollar had mixed performance, falling modestly against the USD but recording sharp gains against the weaker Japanese yen.

## What were the key factors driving markets?

In the US, price pressures are gradually building with core inflation steadily approaching the Fed’s 2% inflation target. Bond markets are expecting the Fed to raise US interest rates in December. Solid economic activity in the US also caused US government bond yields to rise.

While in Europe, concerns that the ECB may tamper rather than extend further policy stimulus in 2017 caused European government bond yields to rise sharply.

Britain’s economic resilience after “Brexit” continued. A surprisingly positive September quarter GDP result and favourable business surveys combined to push UK bond yields higher. Rising UK inflation also negatively impacted UK bond yields.

Australian retail sales improved and there were positive results for the National Australia Bank business survey. Australia’s price pressures for the September quarter picked up speed with sharp price rises for fruit and vegetables raising the annual inflation rate from 1.0% to 1.3%. This has tempered expectations for another Reserve Bank of Australia interest rate cut this year.

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