Economic and market update

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Bob reviews events in Australian and overseas markets during January.

How did markets perform in January?

US shares made record highs in January. The potential for stronger US economic growth and higher corporate profits in 2017 with President Trump's stimulus program buoyed US shares. Positive economic data also proved supportive. US business and consumer sentiment surveys showed solid gains, there was strong consumer spending results and healthy job gains. Yet inflation pressures are building with wages growth picking up speed. Janet Yellen, US Federal Reserve (Fed) chair, warned that the Fed expects to raise interest rates "a few times a year" over the next two years.

European and Japanese shares drifted lower. Investors became more cautious given concerns over President Trump's "America first" rhetoric and the potential negative impact on global trade. Political risk also weighed on European shares given the forthcoming Dutch (March 2017) and French (April-May 2017) elections as well as the German election later this year.

Australian shares fell 0.8% in January. Some of the interest rate sensitive sectors such as Australian Real Estate Investment Trusts (-4.7%) and Consumer Discretionary (-4.3 %) disappointed. Yet the Metals and Mining sector performed strongly with a 6.8% gain given rising iron ore and metal prices.

The Australian dollar (AUD) surged by 4.8% against a softer US dollar given these higher commodity prices. This stronger AUD performance had a negative impact on unhedged global share returns which fell 2% in January.

US government bond yields essentially moved sideways in January awaiting more policy detail on President Trump's stimulus plan. Solid US economic data and rising inflationary pressures suggest that the Fed will continue to raise interest rates in 2017. European government bond yields rose. Stronger European economic data and higher inflation outcomes were key contributors to the rise in bond yields. Political risks with forthcoming European elections also cautioned investors.

Australian government bond yields edged lower in January. Mixed Australian economic activity data and mild inflation were supportive of bond yields. Given competitive pressures in the retail sector and slow wages growth, Australia recorded a subdued 1.5% annual inflation rate for the final quarter of 2016.

What were the key factors driving markets?

The major themes driving markets in January continued to be President Trump's bold stimulus promises as well as trade threats, the prospect of higher US interest rates and the political risks in Europe.

Given solid US economic data and rising inflationary pressures, the Fed is expected to continue raising interest rates in 2017. However financial markets are debating how fast and how high this rise in US interest rates will be.

In Australia, our economic activity remains mixed. There were solid job gains, encouraging results from the National Australia Bank business survey as well as a strong rebound in exports. Yet consumer sentiment and spending are sedate while inflation appears contained. Given this mixed Australian data, financial markets expect the Reserve Bank of Australia to keep the cash rate steady at 1.5% over coming months.