1st June 2015

Woodhall's Wrap

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Budget brings back consumer confidence

- **Budget reaction very favourable**
- **Rate cut by RBA to 2%**
- **Australian jobs still holding up**

The Big Picture

On May 12th we got the Budget we 'had to have'. While the previous Budget was a big step in the right direction – to set Australia on course for a stable future – it was so unpopular that the Government had to soften its stance this time around. Of course people will always be able to find something to gripe about because it is simply not possible to make everyone better off in a budget. Budget's redistribute wealth and income.

The Westpac – Melbourne Institute Consumer Confidence index jumped up a big +6.4% after this Budget. Normally this index falls after a budget. This latest number took confidence back up to above where it was even before the 2014 Budget!

Also, the Government came back in polling – level-pegging with Labor in the latest read. The main focus in the latest Budget was Small Business – with tax reductions and accelerated depreciations. As so many, many people are involved in small business, it is no surprise that the economy will get some sort of a lift – it is just a question of how much.

It was Peter Martin's turn to be the 'favoured journalist of the month' to pre-empt the RBA cut in its rate from 2.25% to 2.00% on May 5th. While a cut – such as that made in February – would normally be expected to give economic indicators a boost, the fact that the RBA removed its 'easing bias' statement from it accompanying notes failed to excite pundits. Indeed, the Bank also cut its economic (GDP) growth forecast by -0.5% to the range 2% - 3% for 2015/16. The Treasury forecast is a fraction more optimistic. However, the Bank would (or is that should?) not have known what was in the Budget when it reduced its growth forecast.

The latest Budget is meant to be 'all about jobs' rather than the 'debt and deficit repair' of last year. The latest estimate is that the Budget will return to surplus by 2019/20 but, of course, debt is accumulating in the interim.

Both the Standard & Poor's and Moody's ratings agencies confirmed their AAA credit ratings for Australian debt after the Budget.

The official (ABS) trend estimate of unemployment for April – published in May – actually fell from 6.2% to 6.1%. Only -2,900 jobs were lost over the month. But the full-time jobs' fall was -21,900 – with part-time hires negating much of that that loss.

And there were some bright signs from overseas. China's trade data was poor but China cut its lending rate for the third time this year and announced an additional $300bn spending on new projects. Its Purchasing Managers' Index (PMI) for manufacturing improved slightly over the month.

The ECB is set to lift its rate of stimulus in Europe for the next two months; Greece seems to be coming to some sort of agreement with its creditors but nobody can really keep up with the dialogue; and EU growth is forecast to be a modest +1.6% for the year. Fitch's credit rating for Europe has improved further on this round of Greece negotiations.

The US Federal Reserve caused a little concern with its announcements on when it will start to raise rates. However, Chair Janet Yellen stated clearly that it could be years before the Fed Funds Rate gets back to 'normalised' levels.

Asset Classes

Australian Equities

The ASX 200 finished flat over the month but Industrials' stocks surged +5.5%. Consumer Staples (e.g. Woolworths) and Financials (e.g. the big banks) went sharply backwards.

In my opinion, the four high yield sectors went into a bubble after the February rate cut which was then burst by the lack of guidance about future cuts in the May RBA statement. These sectors are just back to where they were in January.

At the start of 2014/15 last July 1st, we were predicting this financial year to end at 5,900 on this coming June 30th. Stock markets are inherently volatile but the recent rally from a low of 5,610 keeps 5,900 on the radar. We think 6,300 is on the cards for mid 2016.

Foreign Equities

Wall Street keeps surging to new levels but largely in a sideways fashion. Most major markets were pretty flat in May. Emerging markets slipped a couple of percent.

There seems to have been no repeat of the 'taper tantrums' of 2013 as the US Fed is about to hike rates. Bond markets have been a bit volatile but equities seem to be strong.

Bonds

The Fed's comments certainly put some volatility into bond markets around the world. But there hasn't been much of a flow-on to equities. Our 10-year yield is firmly below 3% so – after tax and inflation – most such bond owners are going backwards.

Interest Rates

The RBA cut its rate to 2.00% in May. The market is divided over whether there will be any more cuts. We suspect there will be one more cut in a few months unless the Budget really sets the economy alight.

The US Fed has all but given up on a June rate hike for fear of going too soon. The first quarter was so bad in the US economy – largely because of weather and the dock strikes on the West Coast. The initial growth estimate for Q1 was only +0.2% and many were expecting that estimate to be revised downwards in subsequent months – and the -0.7% first revision confirmed that view. US Jobs data did jump back after a terrible March figure.

Other Assets

Iron ore prices recovered from their end-of-April slip to gain nearly 10% on the month. Brent oil prices have been relatively stable at above $60 / barrel.

Regional Analysis

Australia

It was not only the Westpac Consumer Confidence index that jumped up after the Budget, the average of the three post-budget ANZ – Roy Morgan indexes was also quite strong.

Retail Sales – measured before the Budget – came in at +0.3% which was fractionally down on the expected +0.4%.

But the big problem in forecasting the Australian economy at the moment is so much of the 2014 Budget has not yet passed through Parliament – and what from this Budget will pass?

It did look a bit like an election budget so there is a realistic chance Tony Abbott will use some bill not passing through the Senate to call a double dissolution before the 2016 Budget.

If Australia follows the UK's lead in voting in a party that has the mechanism to truly lead, it might be a simple matter to get the economy ticking along quite nicely.

At the end of May, the CAPEX (Capital Expenditure) data for business forecasts were released. Expected 2015/16 expenditure is -24% down on that in the current financial year. Markets didn't like that but, as we switch from heavy industry to clever industry, we probably don't need quite as much CAPEX to support the same job growth.

But on Tuesday 2nd June we get the next RBA rate decision, followed by GDP growth on Wednesday 3rd. A rate change is highly unlikely and a soft GDP read looks on the cards.

China

China's Purchasing Managers' Index (PMI) for manufacturing came in today at 50.2 – a fraction up from the 50.1 in the previous month – but slightly down on expectations. A number above 50 signals growing economic growth.

China's reaction to some weaker economic data with both a monetary and a fiscal injection proves they are serious about managing to hold on to a respectable growth target of 7% pa for 2015.

It is a little disturbing that China is building some man-made islands in the South China Sea – in the vicinity of the islands disputed with Japan and others for sovereignty over the last few years. It is more disturbing to read that China plans to place military infrastructure on these islands! And there is an awful lot of oil and gas in the neighbourhood. This news is starting to read like a James Bond movie script!

USA

The particularly poor US nonfarm payrolls (jobs increase) figure reported at the start of April of +126,000 jobs for March was revised downwards to +85,000 – a truly miserable number.

However the latest data were quite strong with +223,000 jobs and a 5.4% unemployment rate. Even average wage growth at +2.2% over the year was promising. This coming Friday's numbers will tell the real tale. Was the March read just a blip that can be written off?

The preliminary GDP growth for Q1 was +0.2% and that was revised over the weekend down to -0.7% (but this was widely expected). Most serious analysts are predicting a much stronger second half for 2015 (around 2% for Q2 and 3% for Q3) but the Fed won't want to pre-empt that with a rate hike just in case.

Europe

Greece is sailing close to the wind in regard to its debt repayments but the end of May witnessed some optimism regarding the negotiations. But whichever way it goes, people are so over Greece that the outcome doesn't really matter anymore – unless you happen to live in Greece.

David Cameron's UK Conservative Party was elected with a majority meaning that it does not need support from a coalition nor cross benchers to go forward for the next five years. And with a House of Lords rather than an elected Senate, Cameron will have no excuses if he fails to deliver. The UK is facing deflation – albeit only a -0.1% fall in the CPI for Q1 – for the first time since 1960!

Rest of the World

Japan's economic growth was a little better than expected. But the big news in the rest of the world is the magnitude of the alleged corruption in awarding various countries the right to host the football (soccer) World Cup. Everyone smelt a rat when Qatar won a bid to host the 2022 Cup in temperatures of over 40^0C but even the long-gone South Africa bid seems to be getting embroiled in the investigation.

It seems Qatar has already spent $200bn on the Cup preparations – or 10 times the amount Russia has spent on the 2018 Cup. Qatar will have serious egg-on-face if it gets the Cup taken away from it.

Recall England got bundled out of the 2018 bid with only two votes. Australia didn't fare much better for the 2022 bid – and both countries spent a lot of money on their bids – and lost big time from the benefits flowing from any successful bid.

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