Economic Snapshot

PARAGEM

November 2015

In summary

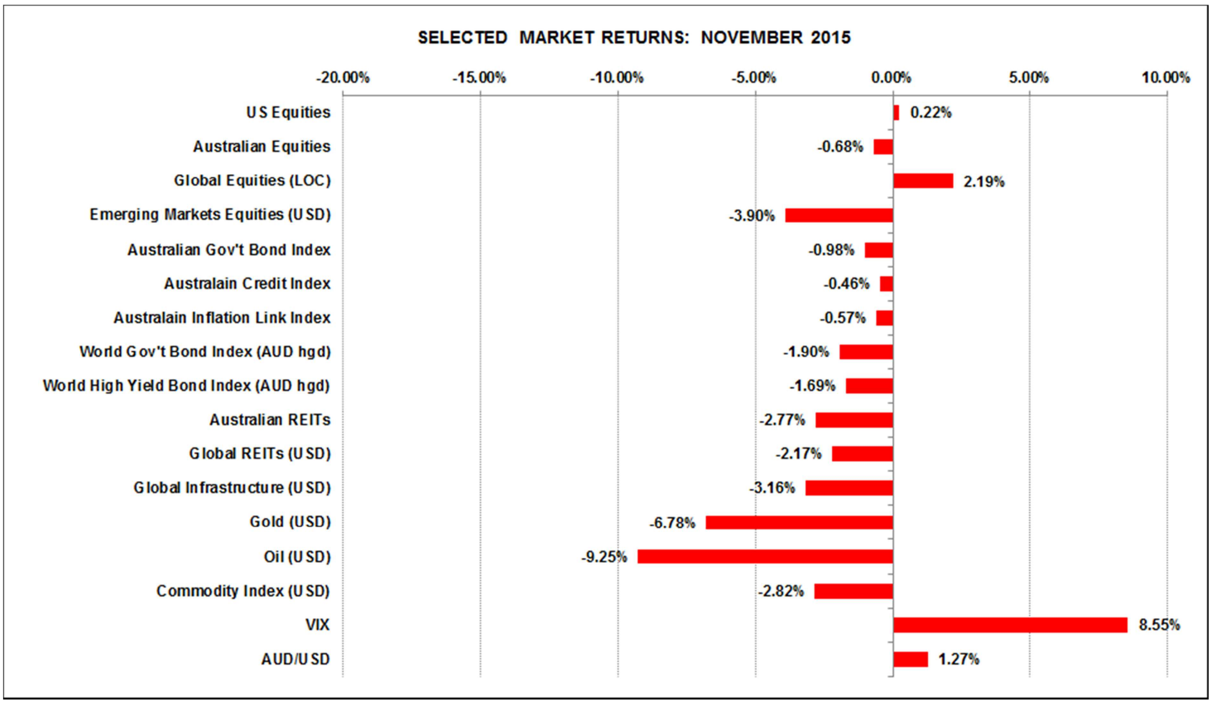
November was cluttered with mixed messages from mainstream media on global financial markets. Markets appear to have ongoing concern about rising US interest rate increases and weak commodity prices have undermined both bonds and equities through November into early December. An unusually clear message from the Federal Reserve about the likelihood of a rate rise in December and the economy's ability to handle it sparked a recovery in risk assets in the second half of the month but it then fell away on exactly the same premise. **This tells investors to focus on fundamentals not fear. The fundamentals are that the economies of the world are likely to do better over the next few years not worse.**

Key economic data in Australia, the US and Europe all suggest scope for modest improvement in economic activity in coming months. However, the manufacturing sector in China continues to slow down as the service sector improves. Again this is nothing new for investment strategists.

The Board of the Reserve Bank left the cash rate unchanged at 2% at its meetings in both November and December. Governor Stevens advised the markets to "chill out" and wait until February before thinking too much more about monetary policy.

Tensions in the Middle East surrounding the war in Syria, the downing of the Russian 'plane and the terrorist attacks in Paris or contributed to volatility at times.

Figure 1: markets remain busy ….going nowhere but oil price falls offer respite



After the solid performance in October, November was a somewhat mixed month for financial markets. Uncertainty about what the Federal Reserve would do with the cash rate, plus the overall state of the US economy, continued to prey upon investors' minds. Further weakness in the price of oil and other key commodities were also a negative factor. Equity markets fell and bond yields rose in the first half of the month, but the Reserves mid-month statement suggesting the US economy is strong enough to withstand an interest rate increase in December, improved the mood and equity markets rallied before slipping a bit at the end of the month. Bond markets were able to recover some ground but still finished the month in negative territory. This Australian dollar was quite robust and managed to reach US$0.7250 towards the end of the month before also slipping back a bit.

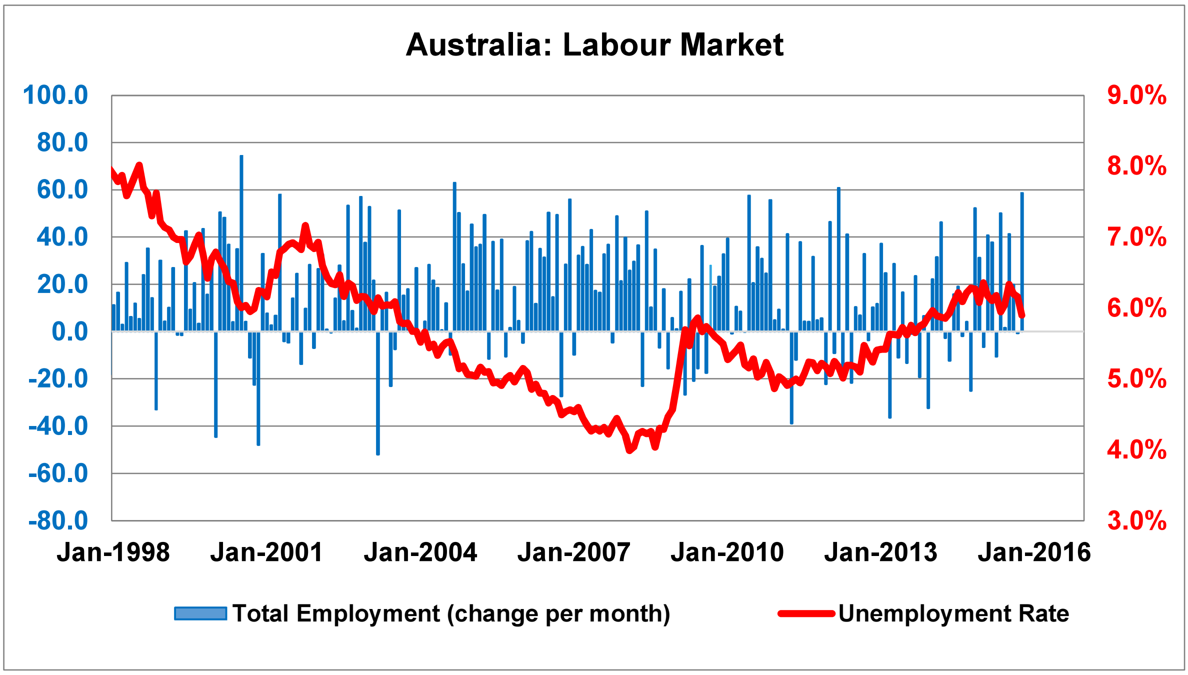
Australia

After months of pessimism about employment prospects in Australia, the October labour market report surprised nearly everyone. Employment grew by 58,600 in October with unemployment falling by 33,400. This brought the unemployment rate down to 5.9% compared with 6.2% in September. In addition, the participation rate rose slightly to 65.0%. Most of the gains in employment were full-time positions (40,000) and hours worked in all jobs rose by 1.2% in the month.

Although the labour market statistics have been less reliable than usual in 2015 and these latest numbers are likely to be revised, they nevertheless present a much more positive view than most commentators and the markets have been expecting. Combined with other indicators, including business conditions and borrowing, external trade and profitability, there are signs of improvement in the Australian economy. To be sure, there is still weakness in the resources sector and investment spending has yet to improve, but the flavour of the better statistics has been reflected in comments from the Reserve Bank suggesting some early cautious optimism about the economy's prospects.

In this context, it is not surprising that the Board of the Reserve Bank remains comfortable with the cash rate at 2%, while still flagging the scope provided by low inflation to cut rates again if required. All this has contributed to some unwinding of the market's expectations about further interest rate cuts, which has in turn helped lift the Australian dollar in recent weeks, despite further falls in key commodity prices. If the current strength of the Australian dollar persists, the Reserve Bank could interpret this as contributing sufficient disinflationary pressure to justify lowering the cash rate.

Figure 2: Great news - The labour market in Australia picked up in October



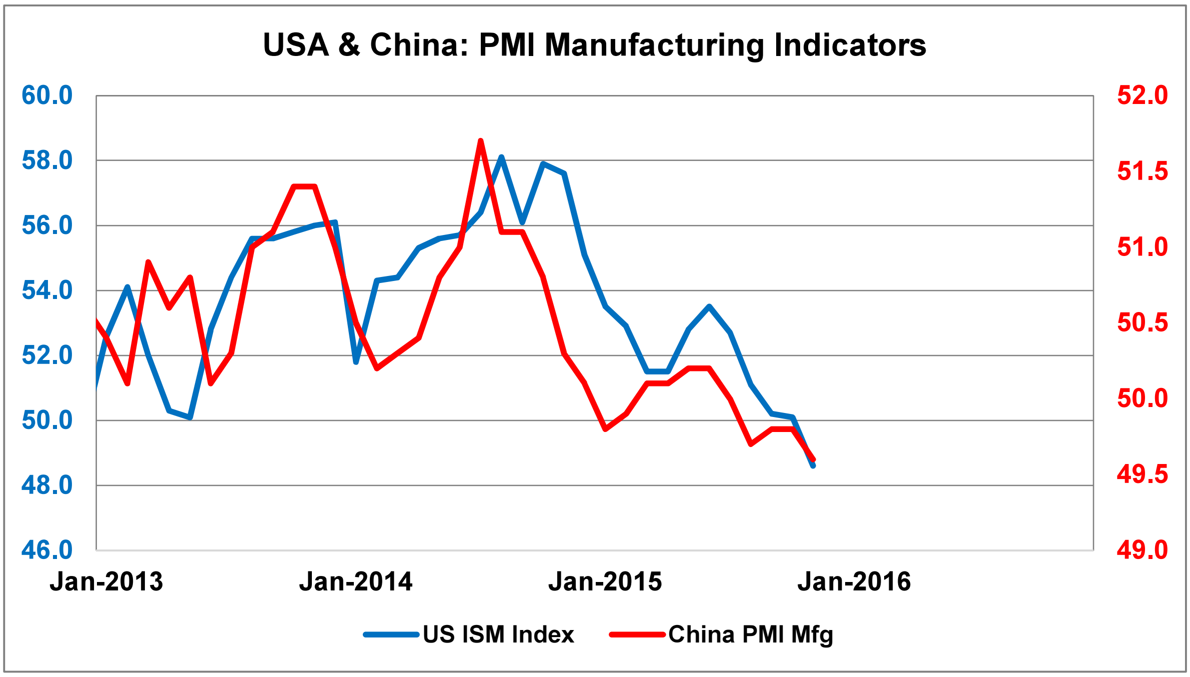
United States

There has been some mixed data from the United States in recent weeks. On the positive side, 271,000 new jobs were created in October which was the biggest result since December 2014. The unemployment rate fell from 5.1% in September to 5.0% and is likely to be below this level in coming months. Wages growth showed some improvement as well. When these figures were released the markets became more convinced the Fed would start lifting interest rates in December. Subsequent statements around mid-month by Janet Yellen and other senior Fed officials reinforced this conviction while at the same time reassuring the markets that the US economy is strong enough to withstand the move. At this point the equity market started to recover the losses seen in the first half of the month. It was not only the Fed's reassurance about the state of the economy that helped this turn in sentiment, but also that, for once, the Fed had sent a clear message which reduced some of the markets' uncertainty. Also, part of the Fed's message was that the path to higher interest rates would be slow and gradual which undermined the US dollar and contributed to the rebound of the Australian dollar.

Other measures of activity from the US were less positive. For example, the key ISM indicator of manufacturing conditions fell further in October to 50.1 but then, contrary to expectations, fell further in November to 48.6. High inventory levels were a factor behind this result. However, the employment component of the index improved significantly in November. This led some commentators to downplay the poor headline figure, while the US equity market hardly reacted to the numbers.

The slowing of manufacturing activity seen in the US has been reflected in other major economies. Figure 3 compares these indicators for the US and China with a very similar pattern between the two. However, both economies continue to show improving conditions in the services sector.

Figure 3: The manufacturing slowdown continues in key economies but is not new news



Europe

In Europe business confidence in Germany rose more than expected in November as did a key index of current economic conditions. Unemployment in the Eurozone fell to its lowest level in nearly four years. The data suggest that improving domestic demand is helping offset some deterioration in the contribution to growth from the trade. Analysts do not expect a rapid improvement in Eurozone growth, but the recent statistics and expectations of further ECB stimulus in December are supporting the view that growth can sustain a moderate, positive pace in 2016.

As we enter the Xmas season, Snapshot wishes readers all the best with a positive tone for 2016. We look forward to reviewing the calendar year for you in earnest and will be allowing ourselves the indulgence of looking forward into likely asset class moves for 2016. This will be in our January edition.