

Global Overview

A Recalibration of Interest Rates

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 22 APRIL 2024

In March, the ASX200 Accumulation Index increased another 3.27% bringing the return over the year to 14.4%. International share markets, as measured by the MSCI World Index, increased 3.01%. The soft-landing narrative dominated the behaviour of financial markets in March. The burgeoning 'risk on' sentiment, however, came to a sudden halt in early April following the release of the inflation and employment data in the US, which reinforces the material recalibration in consensus beliefs on the path of short-term interest rates. Headline inflation recorded 3.5% on an annual basis, and core inflation 3.8%. Of concern, within the data was that shelter inflation remained elevated preventing core CPI from declining. More worryingly, Core services excluding shelter inflation increased rapidly. The annual rate of change recorded 5.0% while the 3-month annualised change stands close to 7.8%. This is the highest reading since June 2022. While most of this rise is associated with transportation services, Federal Reserve officials have often linked this measure to wage growth and underlying inflation.

On the US employment front, the increase in March came in well above expectations. **Wage growth is a key determinant of consumption fundamentals which itself is a large driver of GDP growth.** Although average hourly wages (AHE) increased slightly in March, it eased over the year. Moreover, an equal-weighted version of AHE which adjusts for changes in industry composition remains on a downtrend.

In addition, the longer-term trend of the forward-looking openings, quits and hiring rates continue to point to a deceleration in wage growth ahead. If this trend continues it will lead to lower consumer demand and an easing in inflationary pressures -but importantly, not yet.

The Personal Consumption Expenditure (PCE) report also showed a resilient US economy. As mentioned above consumption is a large part of the US economy. Real personal consumption increased 0.4% in February and remained above its pre-pandemic trend driven by both services and goods. Real personal consumption for services grew at the highest rate since 2021 supported by a low savings rate, which declined to 3.6%, the lowest reading since December 2022 and below the 10Year average around 5%.

Just five months ago, market forecasts were for a drop of two percentage points in the Federal Funds Rate beginning in March 2024. This is a substantial recalibration. Not only have reductions been delayed but the magnitude has now been pared back also.



Emmanuel Calligeris

Chairman of the Investment Committee

➤ **At the time of writing, the interest rate market was pricing just a 0.68% of interest rate reductions in the US, less than the 75 basis points the Federal Reserve projected for 2024.**

In Europe, the central bank has opened the door to an easing at its June meeting as highlighted by the minutes of the March meeting. Whilst the ECB forecasts some bottoming out of economic activity it remains concerned about services inflation, which has been too sluggish and “lent further support to the picture of “last mile” persistence in that component of inflation”. Also, the recent increase in all components, except food, was considered a warning that the fight against inflation was not yet over. The difficulty of the last mile was an important argument for “perseverance in keeping monetary policy sufficiently restrictive”. According to the minutes, “there was consensus that it would be premature to discuss rate cuts at the present meeting”. However, at the same time, the Governing Council concluded that “the case for considering rate cuts was strengthening”.

In China trade and credit data surprised to the downside for March. The economy recorded a -7.5% year-on-year drop in exports which was well below expectations of a decline of 1.9%. There was a 1.9% decline in imports which suggests that domestic demand remains weak. The slowdown in credit growth from 9.0% over the year to 8.7% corroborates the disappointing signal from the import data. Similarly, the ongoing drop in producer prices, a measure of the change in prices that domestic producers receive for their goods and services, fell by 2.8% over the year to March. Combined with the negligible 0.1% rise consumer prices (which fell below expectations of a slowdown from 0.7% to 0.4%) underscore that deflationary headwinds continue to dominate the economy. This means that interest rates are likely to fall further.

In Australia the latest Westpac-MI Consumer Sentiment was somewhat discouraging. February’s gain, initially viewed as a tentative sign of a recovery in confidence, largely reversed in March and April. Australian consumers are experiencing one of the most drawn-out cycles of deep pessimism since the survey began, second only to the sharp economic recession of the early 1990s. The latest

NAB business survey reported a modest fall in business conditions, continuing the downtrend from well above average levels in 2022 to a little below the 10-year average currently. Having experienced a decline in forward orders in 10 of the past 12 months, businesses are cautious over the outlook, with confidence around average levels (+1pt to +1). Encouragingly for inflation, the survey continues to report moderating labour cost and price pressures, now at their lowest levels in around two years. As is the case for consumers, any sustained lift in conditions and confidence is unlikely to be achieved until both the upcoming tax cuts and the beginning of the easing cycle works its way through the economy.

We mentioned last month that “markets seem to be ‘melting up’, with the weight of money sitting on the sidelines continuing to be pushed in. It feels like we are getting into a frothy phase with speculative assets like Bitcoin also surging. Equity markets seem to be front running the expectation of interest rate cuts later this year.

➤ **I expect to see some pullback, as valuations look stretched. At the time of writing, we were beginning to see this pullback occur and it picked up pace as tensions in the Middle East escalated.**

The bond and share market rally seem to have grown weary in the short term given the stellar rise since October 2023. Although we are close to the end of the interest rate tightening cycle in the US, Europe and Australia, with further stimulus required in China, the path of reductions particularly in the US remains optimistic. Strong growth and low inflation with full employment equals economic Utopia. When an economy reaches full employment, the central bank needs to calibrate monetary policy almost perfectly to keep it there. If it does not cut rates fast enough, unemployment will increase; if it cuts rates too fast, inflation will rise. To complicate matters related to monetary policy settings, US Fiscal policy remains highly stimulative. The Congressional Budget Office estimates that the federal budget deficit reached 6.2% of GDP in 2023. In 2015, prior to the Trump tax cuts, the budget deficit stood at only 2.4% of GDP.

Pressure on Australian households from higher mortgage rates, electricity prices and other cost of living pressures will impact consumer spending in the first half. Increased wages, modest interest rate relief later this year, Stage 3 tax cuts and some "cost of living" relief in the Federal Budget, suggest the consumer will be in a better place in the second half. Stimulus in China should be good for Australia too.

ASSET CLASS RETURNS ARE BASED ON

Australian Cash

RBA Bank accepted Bills 90 Days

Australian Listed Property

S&P/ASX 200 A-REIT TR

International Shares

MSCI World Ex Australia NR AUD

Australian Bonds

Bloomberg AusBond Composite 0+ Yr TR
AUD

International Property Hedged

FTSE EPRA/NAREIT Dv REITS TR Hdg
AUD

Emerging Market Shares

MSCI EM GR AUD

International Bonds Hedged

BarCap Global Aggregate TR Hdg AUD

Australian Shares

S&P/ASX 200 TR

RETURNS TO THE 31ST MARCH 2024

	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Australian Cash	0.40	1.10	2.10	4.20	2.20	1.60	1.80
Australian Bonds	1.12	1.03	4.85	1.47	-1.29	0.17	2.59
International Bonds Hedged	0.81	-0.31	5.10	2.53	-2.38	-0.13	2.33
Australian Listed Property	9.70	16.75	36.08	36.58	11.44	6.45	10.52
International Property Hedged	2.90	-0.90	12.40	6.70	0.60	0.40	5.20
Australian Shares	3.27	5.33	14.17	14.45	9.62	9.15	8.27
International Shares	3.02	14.06	20.11	28.72	14.43	14.09	13.43
Emerging Market Shares	2.28	7.07	9.23	11.03	-0.02	3.97	6.63



Virtuous Wealth is a Corporate Authorised Representative 1302201 of
GPS Wealth Ltd | AFSL 254 544 | ABN 17 005 482 726

84 Victoria Street
New Lambton NSW 2305
(02) 4086 4724
contact@virtuouswealth.com.au
https://virtuouswealth.com.au

Prepared by DWA Managed Accounts Pty Ltd

ABN 89 104 065 250 | AFSL 264 125

The information contained in this report has been provided as general advice only. The contents have been prepared without taking account of your personal objectives, financial situation or needs. You should, before you make any decision regarding any information, strategies or products mentioned in this report, consult your own financial advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs. Investment markets past performance are not necessarily indicative of future performance. Whilst DWA Managed Accounts Pty Ltd is of the view the contents of this report are based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by DWA Managed Accounts Pty Ltd and its affiliated entities or any officer, agent or employee of DWA Managed Accounts Pty Ltd and its affiliated entities.