

Read the latest market update from the Economic and Market Research team at Colonial First State.

Economic overview

- Global financial markets were volatile in May, and the MSCI World Index fell by 8.0% in AUD terms.
- Equity markets advanced early in the month, but lost momentum after comments on the outlook for quantitative easing by the US Federal Reserve.
- Global growth concerns also increased following the release of a poor index data from China.
- US economic data was mixed, with GDP growth in the March 2013 quarter revised down slightly to 2.4%.

- US house prices increased by 10.9% over the 12 months to March 31, the biggest rise in seven years.
- The European Central Bank (ECB) eased monetary policy for the first time since July 2012.
- Eurozone GDP fell by 0.2% during the March quarter, posting its sixth consecutive quarter of contraction.
- Japan's real GDP increased by 0.9% during the quarter, a second consecutive quarterly expansion.
- In Australia, the S&P/ASX 200 Accumulation Index declined by 4.5% over the month.
- The Reserve Bank of Australia (RBA) cut the cash rate by 25 bps to 2.75%, its lowest level in 53 years.
- In its statement following the easing the RBA said it had "decided to use some of the scope" afforded to it by the benign inflationary outlook.
- The AUD depreciated by 7.7% against the USD – its largest monthly decline since September 2011.
- Weakness in the AUD was partly attributable to speculation that the US would slow the pace of its quantitative easing program, as well as the cut in the cash rate.



Ryan Felsman
Senior Analyst

Stephen Halmarick
Head of Economic
and Market Research

James White
Senior Analyst

AUSTRALIAN DOLLAR UNDER PRESSURE



Source: Bloomberg

- Australian Federal Treasurer Wayne Swan announced that a significant revenue shortfall would result in a A\$19.4bn budget deficit in 2013/14, despite previously targeting a budget surplus.
- The number of residential building approvals surged by 9.1% in April, which was significantly better than market expectations for a rise of 4.0%.
- The April employment report was volatile in April, surging by 50.1K jobs.

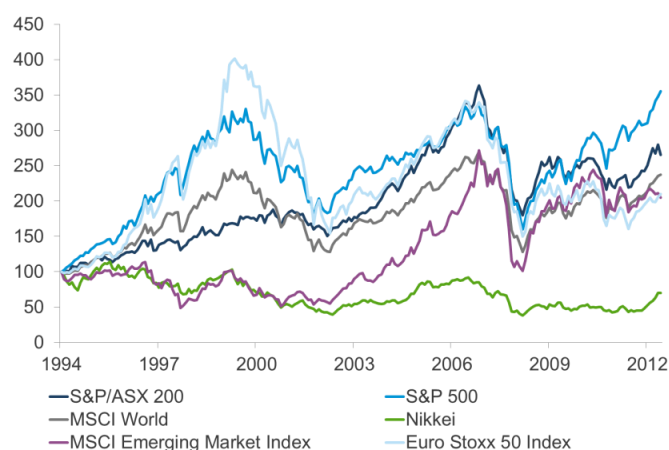
Australian shares

- The ASX200 Index hovered above 5,200 for much of May, but fell-back following the comments from the US Federal Reserve and Chinese President Xi Jinping, who signalled a tolerance for more sustainable growth for the world's second largest economy.
- The S&P/ASX 200 Accumulation Index declined by 4.5%, effectively reversing the gains made during April, lagging global indices.
- For the first time in several months, stocks in the Resources sector outperformed those in the Financials sector.
- The release of the Federal Budget in mid-May did not have any noticeable impact on the Australian share market as a whole.

Global shares

- Global equity markets were mixed in May with developed markets generally outperforming their emerging market counterparts.
- In AUD terms, emerging market equities rose by 5.1%, lower than the 8.0% gain in developed markets.

GLOBAL EQUITY MARKETS. INDEX = 100 DECEMBER 1994



Source: Bloomberg

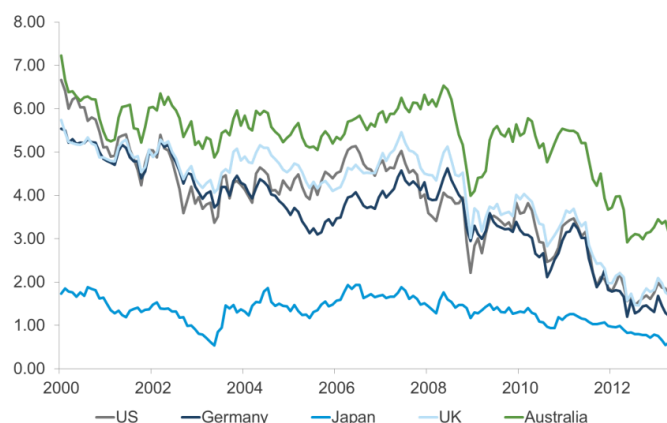
- In the US, the S&P500 Index increased by 2.1% in May, reaching a new record high towards month-end, spurred on by strong economic data releases.
- European equity markets were mostly stronger, buoyed by the European Central Bank's continued aggressive policy stance, reduced political uncertainty in Italy and a potential shift towards easing austerity measures.
- The one European equity market that was an exception was Spain, as Spanish investors sold Spanish banking stocks on growing concerns that Madrid will be unable to prop-up the debt-laden sector without further ECB assistance.
- Japanese equity markets were extremely volatile in May. The Topix fell by 2.5% during the month, its first monthly drop after eight consecutive monthly increases.

- Markets were mixed in Asia ex-Japan. The MSCI Asia ex-Japan Index increased by 6.5% in AUD terms.
- In China, the Shanghai Composite Index rose by 5.6%, supported by the very strong performance of the Information Technology (+14.0%) sector.
- Weaker economic growth and falling inflation across Emerging Europe, Middle East and Africa (EMEA) prompted several central banks to loosen monetary policy further in May.

Fixed interest and credit

- Longer dated high grade global bond yields in the G4 bond markets (US, Germany, UK and Japan) increased sharply in May.
- The 10-year US Treasury bond returned -1.91% over the month, its lowest return since December 2010.
- Commonwealth Government Securities (CGS) bond yields increased sharply in May.
- Longer-dated CGS yield movements were driven primarily by the sell-off in US Treasury yields.
- Australian semi-government bonds performed very strongly early in May, with spreads to bond tightening further.

DEVELOPED MARKETS 10-YEAR BOND YIELDS (%)



Source: Bloomberg

- The UBS Composite Bond Index declined during May, finishing the month down by -0.1%.
- All other fixed rate indices posted weak, positive returns led by the Credit Index (+0.3%) and the Supranational/Sovereign Index (+0.2%).
- Global credit markets were also driven by increased volatility in the US Treasury market.