

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

## Market and economic overview

### Australia

- The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.50% at the 3 December Board meeting, changing its policy statement very little from November.
- Public spending was seen as “quite weak” and the rise in the unemployment rate is “likely to persist in the near-term”.
- The Australian Government’s Mid-Year Economic and Fiscal Outlook (MYEFO) released on 17 December detailed a substantial deterioration in Australia’s fiscal position. The Australian budget deficit for 2013/14 is now estimated at \$A47 billion, 3% of GDP, well up on the budget-time estimate (by the previous government) of \$A18 billion or 1.1% of GDP.
- Economic data released in December was mixed.
- The September quarter GDP report confirmed that the pace of Australian economic growth continued to slow. GDP rose by a slightly lower-than-expected 0.6% per quarter. This took the annual economic growth rate down marginally to 2.3% per year.
- Australian household sentiment was adversely affected by the political wrangling over the debt ceiling (which was eventually removed), foreign investment (GrainCorp) and likely domestic industry job losses (Holden and Qantas).
- Employment increased by 21,000 jobs in November, but the unemployment rate rose by 0.1% points to 5.8%.
- Annual building approvals surged by 23.1% per year in October driven by a sharp 47.7% per year jump in multi-family housing approvals.

### United States

- The US Federal Reserve (‘The Fed’) announced a reduction or ‘tapering’ in the QE3 bond purchase program on 18 December. Beginning in January 2014, the Fed’s monthly asset purchases will be \$US75



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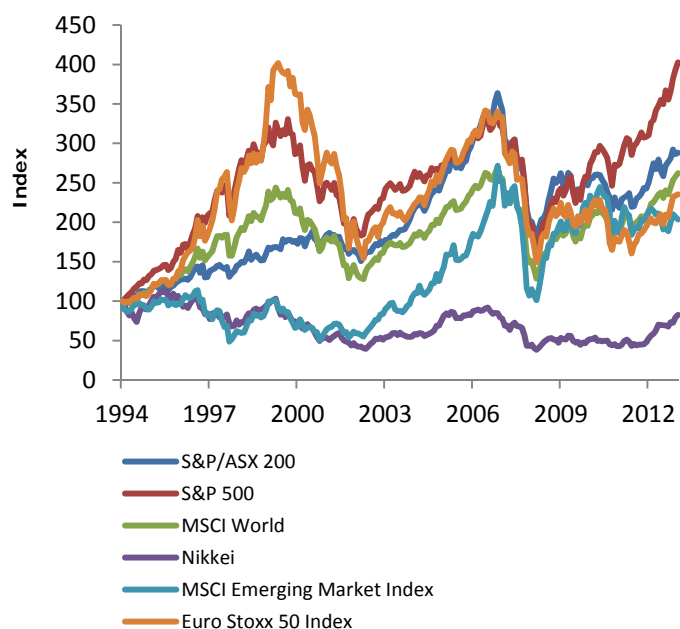
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billion per month, rather than US\$85 billion per month.

- The Fed, however, strengthened its forward guidance on monetary policy, stating that official interest rates will remain near zero “well past the time the unemployment rate declines below 6.5%.”
- September quarter GDP growth was revised-up to an annualised pace of 4.1% per year, rising from a previously estimated 3.6% per year growth rate. This was the strongest outcome since the December quarter of 2011, due largely to rising inventories – suggesting that US companies were confident about demand prospects for goods and services.
- The October employment report was strong, rising by a healthy 203,000 jobs – well ahead of market expectations for +185,000 jobs growth. The unemployment rate fell by 0.3% points to 7.0%, as the participation rate rose by 0.2% points to 63.0%.

### The Fed announces QE3 taper but developed equity markets still rise



Source: Bloomberg as at 31 December 2013. Past performance is not an indication of future performance.

### Europe

- The European Central Bank (ECB) announced new economic growth forecasts with GDP growth of -0.4% per year in 2013, 1.1% per year in 2014 and 1.5% per year in 2015 now expected. Despite small upward revisions in

2014 and 2015, risks to the economic outlook remain to the downside.

- Headline CPI inflation is forecast at 1.4% per year in 2013, 1.1% per year in 2014 and 1.3% per year in 2015. The small downward revision in 2014 confirmed that inflation will remain subdued in the medium-term.

### United Kingdom

- The unemployment rate fell to a 4½ year low of 7.4% in October, declining towards the 7% threshold at which BoE officials say that they will consider raising interest rates.
- The rate of inflation in the UK fell slightly in November, with CPI at 2.1% per year, down from 2.2% in October. Price pressures remained moderate compared with the pace of increase seen in recent years.

### Japan

- The much anticipated Japanese economic stimulus package worth \$US81 billion was unveiled on 6 December amid signs of a weakening recovery.
- Core CPI posted a sixth straight gain in November with a 1.2% per year rise. It now appears that Japan is moving steadily out of its deflationary state.

### China

- Short-term interbank borrowing rates surged to their highest level since June with the 7-day SHIBOR rate touching 8.9% on 23 December due to strong year-end commercial bank demand. The People’s Bank of China was eventually forced to inject RMB200 billion into money markets to ease conditions.

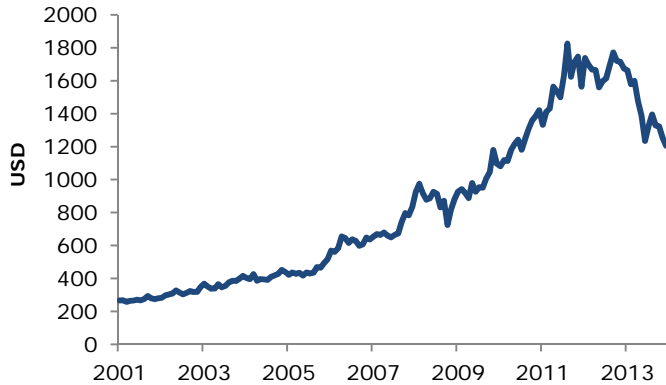
### Soft commodities

- Commodity prices were mixed in December. Oil (+1.0%) rose on supply concerns due to unrest in South Sudan and the refusal of Libyan rebels to relinquish control of three key oil ports.
- Gold fell sharply (-3.8%) following the Fed’s announcement that it would reduce its asset purchases. Iron ore prices declined (-1.6%) as Chinese steel mills restricted purchases on tight cash flows and lending associated with

the spike in short-term rates. Steel prices weakened to \$US134.20 from \$US136.40.

### US Fed tapering weighs heavily on gold

Gold (USD per Troy Ounce)

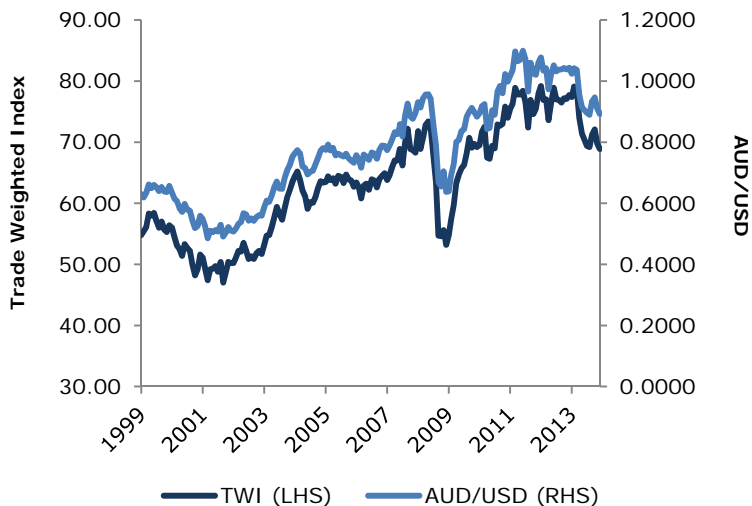


Source: Bloomberg as at 31 December 2013.

### The Australian dollar

- Overall, the AUD fell by 2.0% to \$US0.8927 in December, hitting a three-year low of \$US0.8821 on 18 December.

### The Australian dollar is still "uncomfortably high" despite hitting a 3-year low against the US dollar



Source: Bloomberg as at 31 December 2013. Trade Weighted Index, AUD/USD currency

### Australian shares

- Australian equities finished 2013 strongly, increasing by 4.5% in the four days following the Fed's tapering announcement. Prior to this, the Index dipped to a four month low on 12 December amid a flood of capital raisings

and company earnings downgrades from QBE, Qantas and WorleyParsons.

- The S&P/ASX 200 Accumulation Index added 0.79% during December, lifting returns for the 2013 year as a whole to 20.2%.
- Energy (+3.3%) shares performed well, reflecting the rising oil price. Other commodity prices were mixed – iron ore and gold prices drifted lower, but the coal price rose to its highest level in more than six months. These movements had a mixed influence on companies within the materials (+2.4%) sector.
- Qantas Airways shares reached an all-time record low (-10.3%) after forecasting a \$A300m loss in the first half of 2014. S&P lowered the airline's credit rating by one notch to sub-investment grade (BB+/Negative outlook) status.
- QBE declined sharply (-26.5%) after announcing an expected net loss of \$A250m in the 2013 financial year due to claims provisioning and intangibles write-downs in North America. Fitch downgraded QBE's credit rating by one notch to 'A-'.

### Property

- The Australian listed property sector declined by 1.33% in December. A-REITs underperformed the broader Australian sharemarket, which rose by 0.79%.
- The S&P/ASX 200 Property Accumulation Index added 7.11% as a whole over 2013. This represents a reversion to 'normalised' performance for the asset class following its total return of 33.0% in 2012.
- At a stock-specific level, Westfield Group (-3.0%) and Westfield Retail Trust (-2.6%) announced a significant corporate restructuring program. Under the proposed changes, Westfield Group's Australian and New Zealand businesses will demerge from its international business and merge with Westfield Retail Trust. Two new entities will be established - Scentre Group and Westfield Corporation. Scentre Group will be an internally managed A-REIT focused on Australia and New Zealand, while Westfield

Corporation will contain US, UK and European property developments and assets.

- Australand Property Group (+5.3%) and Investa Office Fund (+3.3%) were the strongest performing A-REITs in December.
- Stockland Group (-3.1%) underperformed in December, despite giving an operational update where the company re-affirmed FY14 EPS growth guidance. Achievement of the 6% growth rate will be dependent on whether the first settlements of the Western Australia Cayella project fall into the 2014 financial year.

### Global developed market shares

- Global sharemarkets stuttered in early December before a 'Santa-Claus' rally kicked-in over the latter part of the month. The early weakness was largely driven by investor uncertainty surrounding the US Federal Reserve's mid-month meeting and potential stimulus withdrawal.
- The MSCI World Developed Markets Index reached a 6-year high, increasing by 2.0% in USD terms and 4.0% in AUD terms over the month.
- US equity market participants took the Fed's tapering announcement in their stride with the S&P500 Index increasing by 1.7% immediately following the announcement and 2.4% for the month, reaching record highs.
- In Europe, the Euro Stoxx 50 Index lifted by 0.7% and the London FTSE100 Index rose by 1.5%. In Asia, the Japanese Nikkei 225 Index surged by 4.0%, the stand-out performer for a second consecutive month in local currency terms.

### Global emerging markets

- The MSCI World Emerging Markets ('EM') Index decreased by 1.5% in USD terms, but increased by 0.4% in AUD terms in December. The US Federal Reserve's tapering decision, anti-government protests in Turkey and Thailand, combined with liquidity concerns in China dampened sentiment. 2013 was the worst calendar year performance for the MSCI EM Index (-2.0%) since the Asian Financial Crisis in 1998.
- Indian shares were a strong performer with the MSCI India Index increasing by 3.3% in USD terms in December. Shares were supported by the opposition Bharatiya Janata Party's positive showing in state elections and the Reserve Bank of India's surprise decision not to hike benchmark interest rates.
- Members of Thailand's opposition Democrat Party resigned en masse on 8 December, forcing Prime Minister Yingluck Shinawatra to dissolve parliament a day later. A snap election has been called for 2 February 2014. However, the Democrat Party has indicated that it will boycott the poll. The political fall-out led to significant foreign net selling of Thai (-5.3%) shares of \$US1.3 billion for the month.
- The MSCI Emerging Markets EMEA Index declined by 1.0% in USD terms, but increased by 0.9% in AUD terms over the month. Turkish (-10.6%) shares led the Index lower due to a corruption scandal involving the sons of three cabinet ministers from the ruling AKP and high-profile businessmen. Allegations of bribery for construction projects as well as illicit money transfers to Iran shook Prime Minister Tayyip Erdogan's grip on power.

### Need more information?

Please speak with your financial adviser or visit our website at [colonialfirststate.com.au](http://colonialfirststate.com.au). Alternatively, you can call us on 13 13 36.

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