

Economic and market update

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Bob reviews events in Australian and overseas markets during December.

How did markets perform in December?

Global shares made strong gains in December as US shares surged to record highs. President-elect Donald Trump's ambitious economic stimulus program is seen as positive by markets despite the lack of policy detail. The US Federal Reserve's (Fed's) 0.25% interest rate increase in December had minimal impact on markets given the Fed's guidance that future interest rate rises should be "gradual".

European shares recorded surprisingly robust gains in December. Concerns over Italy's constitutional referendum proved to be only temporary. Investors gained comfort from positive European business surveys and consumer spending. The European Central Bank's announcement to extend their asset purchase program to December 2017 also supported shares.

Japan's share market surged higher with the benefit of a weaker yen currency and stronger business surveys.

Australian shares performed well in December as stronger iron ore and oil prices supported the Resources sector. Even interest rate sensitive sectors such as Australian Real Estate Investment Trusts (6.8%) and Utilities (8.7%) managed to rebound given some stabilisation in Australian bond yields.

Global bond yields were mixed in December. US government bond yields climbed further given the prospect of larger budget deficits and higher US government debts under the Trump stimulus plan. This rise in US government bond yields was also supported by the Fed raising their median forecast for US interest rates in 2017. European government bond yields however edged lower in December. Political risks with Italy's December referendum as well as the French and German elections in 2017 supported European bond markets.

Australian government bond yields appear to be stabilising after the sharp rises seen in recent months. Mixed economic activity data in December served to cap the rise in bond yields. The Federal Government's mid-year budget update also provided some assurance to the credit rating agencies to maintain Australia's "AAA" rating.

The Australian dollar weakened in December against the stronger US dollar (USD). The prospects of further US interest rate rises in 2017 favoured the USD at the expense of all the major currencies.

What were the key factors driving markets?

The major themes driving markets in December continued to be Trump's promises of corporate tax cuts and infrastructure spending, as well as political risks in Europe.

In the US, economic activity was positive with solid consumer spending and job gains, thereby suggesting that its economy enters 2017 with considerable momentum.

In Australia, our economic activity was mixed. We recorded a rare contraction in activity in the September quarter with real GDP declining by 0.5%. This was countered by solid job gains, stronger retail sales and a stable National Australia Bank business survey. This suggests that our weak GDP result should only be a temporary growth setback.

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