Economic and market update

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Bob reviews events in Australian and overseas markets during May.

How did markets perform in May?

Global shares were initially soft in May as concerns over the impending US interest rate hike weighed on markets. However there were strong share price gains in the final week of May given solid US and European economic data. US and European shares ended the month with price gains of around 1.5%. Japanese shares benefited from a weaker yen currency performance during May with Japan's Nikkei Index rising by over 3%.

Australian shares were solid performers in May with the S&P/ASX200 Accumulation Index up 3.1%. Investors favoured Australian banks given their high dividend yield. However resource shares were generally weaker given the falling iron ore price in May.

Despite more assertive commentary from the US Federal Reserve (Fed) indicating the prospect of rising interest rates in "coming months", US government bonds were comparatively stable with the US 10 year government bond yield drifting around 1.84%.

Australian government bonds rallied strongly given the Reserve Bank of Australia's (RBA) interest rate cut and trimming their inflation forecast over coming years. Commonwealth 10 year bond yields fell from 2.64% at the start of May to close the month at 2.30%.

The Australian dollar (AUD) weakened in May with the RBA's interest rate cut and lower iron ore prices weighing on the currency. The AUD declined from 0.76 at the start of May to close at 0.72 against the American dollar at month end.

What were the key factors driving markets?

Global economic data was mixed in May.

US economic data had both positive and negative results. The manufacturing business surveys were softer. However there was an encouraging surge in April retail spending as shoppers returned to the mall. Housing construction strengthened while the labour market recorded solid jobs growth in April. Given the improving US activity results and the low 5.0% unemployment rate, the Fed indicated the likely prospect for raising interest rates in "coming months".

China's economic activity was softer. China's industrial production slowed to a 6% annual pace in April. Retail sales have moderated to a 10% annual pace but remain resilient. China's credit growth is still strong which has allowed China's residential property markets to record annual 4% price gains.

European economic data was favourable. The European Commission survey for April shows positive economic sentiment. Europe's unemployment rate was stable at 10.2% in April which is the lowest jobless rate since 2011. However price pressures remain sedate in Europe with annual inflation near 0%. Accordingly, the European Central Bank (ECB) has kept their policy stimulus program of negative deposit interest rates and asset purchases.

Britain's pending vote on 23 June on whether to withdraw from the European Union is still causing concern. Britain's business surveys have weakened; industrial production is subdued while jobs growth has slowed.

Emerging markets provided mixed signals. India's annual economic growth surprisingly surged to 7.9% in the opening quarter of 2016. However Brazil's economy remains in a recession as well as struggling with high inflation. Brazil's President Dilma Rousseff has stepped down awaiting impeachment proceedings.

Australia recorded moderate economic activity data. Australia's labour market achieved solid jobs growth in April with the unemployment rate remaining steady at 5.7%. The National Australia Bank's business survey shows confidence remains favourable. Home building approvals for April recorded strong gains while consumer sentiment surged higher in May. Consumers appear to have been more encouraged by the RBA's decision to cut interest rates by 0.25% to 1.75% in May.

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