

2013/14: A very good year

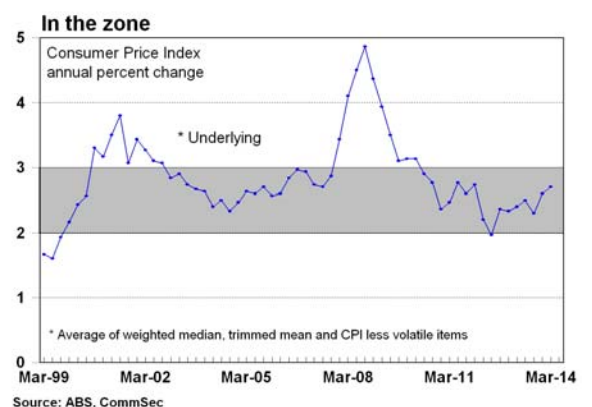
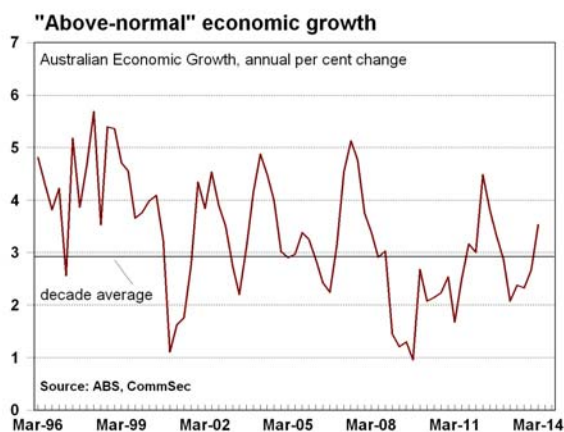
Economic & financial perspectives

- **A good year:** Total returns on Australian shares (All Ordinaries Accumulation index) rose by 17.6 per cent in 2013/14 after lifting by 20.7 per cent in 2012/13 – the best back-to back returns in seven years.
- **Other returns higher:** Returns on dwellings are up 14.7 per cent while returns on government bonds have lifted by 5.4 per cent. A rare event – bonds, property and shares have all lifted over the past year.
- **Financial markets:** The Aussie dollar held in a US11 cent range over 2013/14, the smallest range in eight years. The cash rate stands at a 54-year low of 2.50 per cent with only one change in the year – the quarter percent rate cut in August 2013.
- **Impressive economic credentials:** The economy is recording ‘above-average’ growth; inflation is contained; interest rates are at 54-year lows; and the current account deficit is the best (lowest) in 34 years.

The report is useful to assist investors start planning for 2014/15

What does it all mean?

- Overall, it has been a positive year, despite a raft of challenges such as geopolitical events (Egypt, Tunisia, Libya, Ukraine and Iraq, to name a few), the Federal Election, the shutdown of the US Government and even weather events like the harsh winter experienced in the Northern Hemisphere.
- Returns on shares, residential property and bonds have all lifted over the past year while interest rates and the Aussie dollar have ended little-changed on a year ago.
- The economy has grown by 3.5 per cent over the year to March (latest data), above longer-term averages of around 3 per cent. It is expected that that economy grew by around 3 per cent for the full 2013/14 year and we expect growth of around 3.3 per cent next year. Inflation may ease from 2.7 per cent to 2.4 per cent over the coming financial year while the unemployment rate may hold reasonably steady just below 6 per cent.
- What this all means is that it has been a very good twelve months for our economy and investments. While people



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may fret about the Budget, if they took a big picture view they would realise that there is little to worry about.

What does the data show?

International economy

- **The International Monetary Fund** estimates that the global economy grew by 3 per cent in 2013, below the long-term average growth rate of 3.6 per cent. In April the IMF estimated the global economy would grow by 3.6 per cent in 2014 and 3.9 per cent in 2015. However in the period since, the IMF downgraded its view on the US economy.
- **China** is tipped to grow by 7.5 per cent this year after 7.7 per cent growth in 2013.
- The IMF cut its forecast for **US economic growth** in 2014 from 2.8 per cent to 2.0 per cent, due largely to the harsh winter weather that affected growth in the March quarter. But the IMF has retained its forecast for 3 per cent growth of the US economy in 2015.

Domestic economy

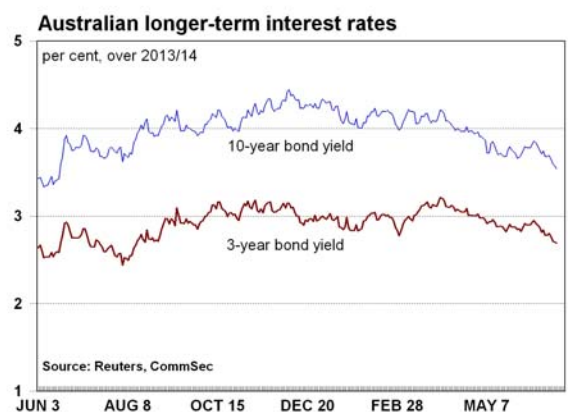
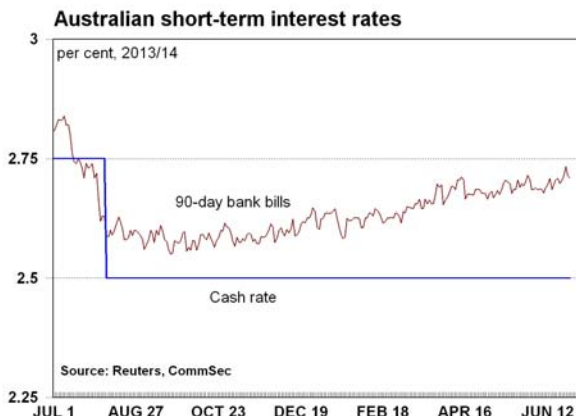
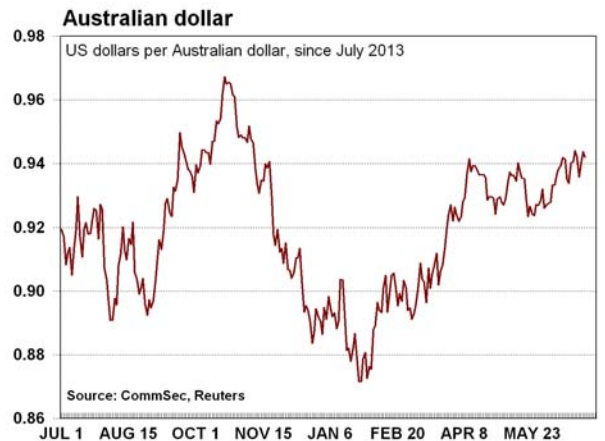
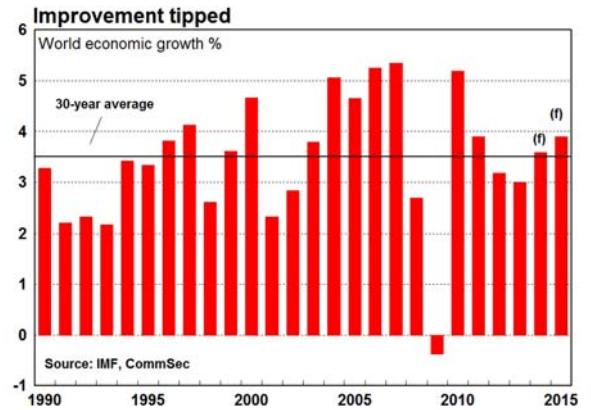
- **The Australian economy** grew by 2.7 per cent in 2012/13 and will probably grow by around 3.0 per cent in 2013/14. In the year to March 2014 the economy grew by 3.5 per cent – above the decade average of 2.9 per cent and the 15-year average of 3.1 per cent.
- The **inflation rate** stands at 2.9 per cent with the underlying rate at 2.7 per cent. For 2013/14 as a whole, the headline rate of inflation should be around 2.7 per cent with the underlying rate around 2.6 per cent.
- In June 2013 the **jobless rate** was 5.7 per cent and the latest rate (May 2014) is 5.8 per cent.

Interest rates

- The **cash rate** stands at a 54-year low of 2.5 per cent, down from 2.75 per cent at the end of June 2013, courtesy of quarter percent rate cut in August.
- The market-determined **90-day bank bill rate** has fallen from 2.81 per cent to 2.71 per cent over 2013/14. Yields on the long bond – **10-year government bonds** – have eased from 3.75 per cent to 3.54 per cent.
- The **variable housing rate** stands at 5.95 per cent – just up from 5.75 per cent which existed briefly from April-May 2009 which was the lowest rate in 46 years. The **3-year fixed rate** stands at 5.20 per cent, just above the record low of 5.1 per cent.

Currencies

- **The Aussie dollar** was little-changed over 2013/14. The Aussie finished 2012/13 at US92.75c, traded up to US97.55c on October 23 2013 and down to US86.58 cents on January 24 2014. The Aussie ended the year at US94.2c.
- The Aussie dollar’s range of just under US11 cents was the smallest since 2005/06.
- We have calculated that the Aussie is 34th strongest against the US dollar of 117 currencies tracked. The



strongest currencies have been the New Zealand dollar (up 11.6 per cent), South Korea won (up 11.4 per cent), UK pound (up 11.1 per cent) and Iceland krona (up 9.2 per cent). Weakest currencies have been Iran rial (down 109.2 per cent), Ghana cedi (down 63.5 per cent) and Argentina peso (down 51 per cent).

Commodities

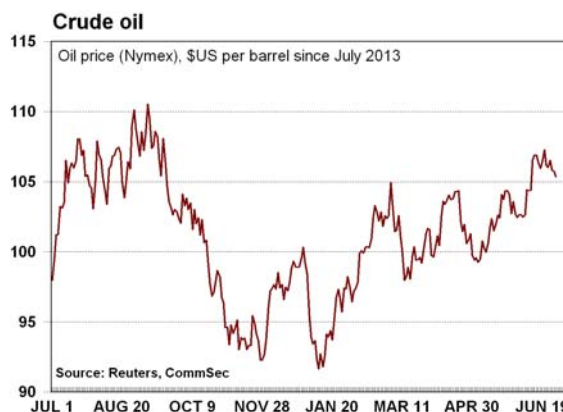
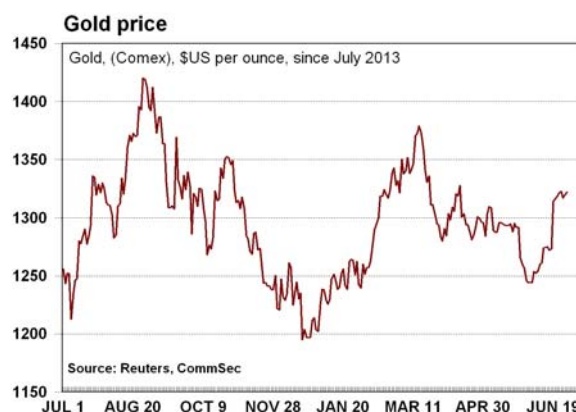
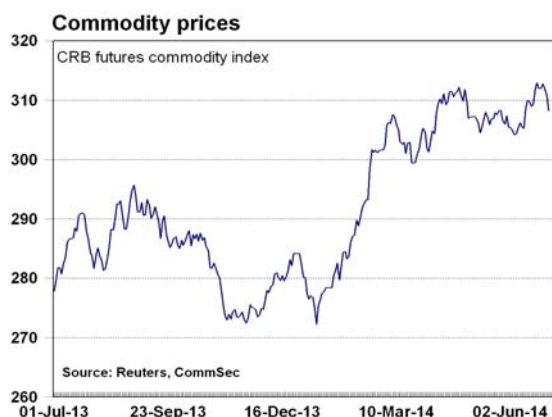
- The **Commodity Research Bureau** index of commodities prices has lifted by almost 12 per cent over 2013/14, outperforming the Aussie dollar.
- In terms of those commodities with particular relevance to investors or the economy as a whole, the gold price lifted by 8 per cent over 2013/14 with beef up almost 20 per cent, crude oil up 9.1 per cent, nickel up 39 per cent and zinc up 21.6 per cent. Amongst the declines have been rice (down 21.8 per cent), thermal coal (down 10 per cent), wheat (down 13.6 per cent) and iron ore (down 19.5 per cent).

Sharemarket

- **The Australian sharemarket** started 2013/14 with the All Ordinaries at 4,775.4; the low-point was 4,682.4 in early July 2013 while the high was 5,516.1 on April 29. The All Ordinaries finished 2013/14 at 5,382 points, up 12.7 per cent on the year. The ASX 200 rose by 12.3 per cent in 2013/14 to 5,396.
- **Mid-sized companies** have out-performed over 2013/14 with the MidCap50 index up by 16.4 per cent, ahead of the 12.0 per cent growth of the large cap ASX50 index and the 9.6 per cent increase of the smaller company index, the Small Ordinaries.
- **Of the 20 current industry sub-sectors**, all but one has grown over 2013/14. The under-performer was Food Beverages & Tobacco Manufacturing, down by 23.0 per cent. Strongest growth has been by the Diversified Financials (up 34.9 per cent) followed by Consumer Services (up 18.9 per cent) and Banks (up 16.9 per cent). The Resources sector has grown by 15.9 per cent while the A-REIT sector (Property Trusts) has lifted by 7.9 per cent.
- Australia finished 37th of 73 global bourses in 2013/14, or around the mid-point of bourses. Best performer was Argentina (+165 per cent) followed by Venezuela (up 83.7 per cent) and Egypt (up 71.8 per cent). Worst performers were Zimbabwe (down 11.7 per cent), Kuwait (down 10.3 per cent) and Chile (down 3.9 per cent).
- In US dollar terms the Morgan Stanley Capital International index for Australia grew by 16 per cent in 2013/14 with the MSCI World index (less Australia) up by 21.5 per cent.

Investment returns

- **Total returns on Australian shares** (All Ordinaries Accumulation index – share prices and dividends) grew by 17.6 per cent in 2013/14 after lifting by 20.7 per cent in 2012/13. It was the best back-to-back returns for Aussie shares in seven years.
- Returns on dwellings are up 14.7 per cent while returns on government bonds have lifted by 5.4 per cent. A rare event – bonds, property and shares all rising over the past year.



Outlook for 2014/15

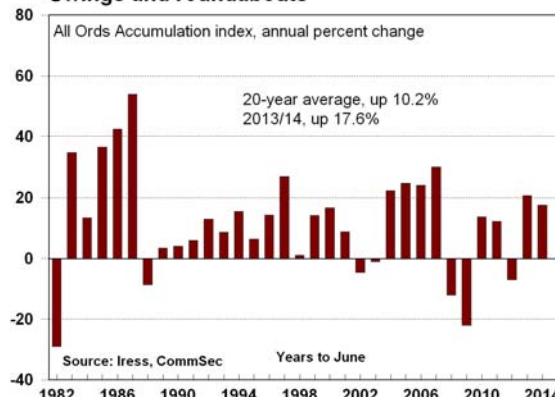
Global economy

- The global economy is still in healing mode after the global financial crisis (GFC). Some may be disappointed that advanced economies haven't bounced back more forcefully but past experience shows that economies heal only slowly after financial crises.
- It takes time for consumers and businesses to become more confident about borrowing, spending, investing and employing – even with interest rates close to zero and with central banks effectively printing money to spur growth.
- Because the 'animal spirits' are tame, deflation still represents the greatest risk, rather than inflation – a seemingly bizarre situation given the amount of stimulus that is being applied to economies.
- **The US economy** is well down the road to recovery although momentum was checked by the harsh winter weather late in 2013 and in the early weeks of 2014. The Federal Reserve is in no rush to lift interest rates, especially with inflation still well contained. But the expectation is that interest rates will start rising from mid to late 2015.
- **The European economy** remains fragile but the worst appears behind it. Stronger growth in North America and Asia will be important in lifting 'other boats' such as European economies. The UK appears furthest down the recovery path and the Bank of England is softening up consumers and businesses for higher interest rates.
- **The Chinese economy** continues to mature. Economic growth is around 7.5 per cent and that pace of growth will slowly ease over time as the economy gets larger, incomes rise and prosperity spreads to more consumers and businesses. The authorities are keen to improve the standard of living for Chinese consumers rather than focus on the rate of growth. China still has a long way to go in the expansion phase of industrialisation, perhaps 10-15 years.

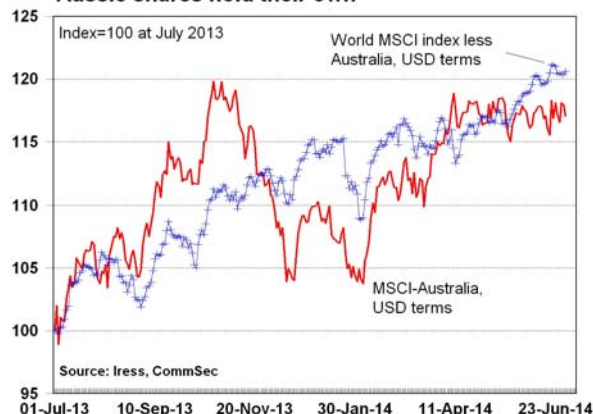
Domestic economy

- If five or 10 years ago someone told you that Australia would have inflation near 2.7 per cent, economic growth near 3.5 per cent, unemployment below 6 per cent, a cash rate at 2.5 per cent and Aussie dollar near US94 cents, you would have cast dispersions on their economic abilities. But those are the metrics operating in Australia. Add in the fact that the broad trade position – the current account – has produced the smallest deficit in 34 years and that is the icing on the cake.
- The coming year looks like being very similar to 2013/14, the hope being that the pace of growth picks up a touch, allowing unemployment to ease modestly. The Reserve Bank and Federal Treasury remain cautious about the outlook, although they have been pleasantly surprised that outcomes have proved a little better than expected.

Swings and roundabouts



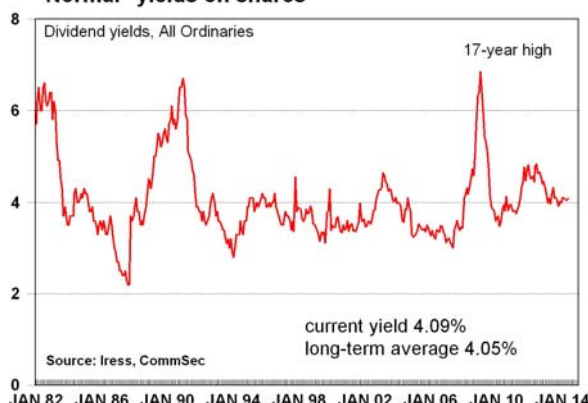
Aussie shares hold their own



Valuations



"Normal" yields on shares



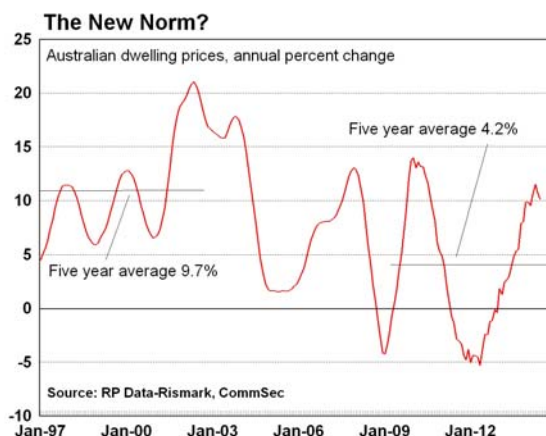
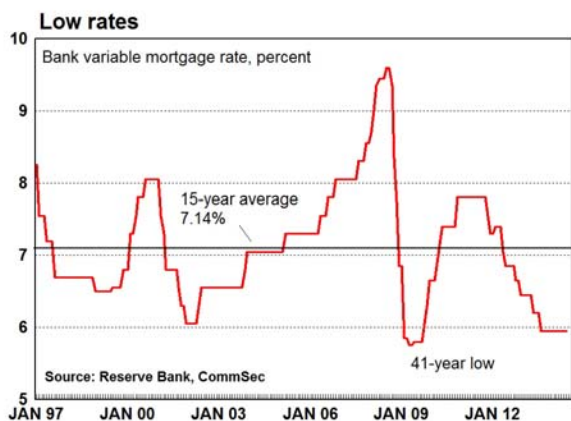
- The economy is likely to grow around 3 per cent in 2014/15 with inflation in the top end of the Reserve Bank's 2-3 per cent target band and unemployment between 5.5-6.0 per cent.
- The economy is re-balancing: moving away from mining investment as a driver of economic growth to increased home construction and exports of resources. The trade accounts are likely to stay in surplus while the broader current account deficit should continue to contract to near balance in the next few years.
- There appear few risks to the economy apart from domestic politics and global geopolitics (such as Iraq and Ukraine).

Financial markets

- The Commonwealth Bank Group (includes CBA, CommSec, BankWest and Colonial First State) expect interest rate 'normalisation' to start in 2014/15, possibly as early as November/December 2014. That is, the Reserve Bank will eventually have to lift the cash rate from its super-stimulatory 54-year low of 2.5 per cent to more normal levels associated with a healthy economy.
- The cash rate could rise to around 3.25 per cent in mid-2015 and 3.5 per cent in late 2015. Much will depend on the state of the job market and the level of the Australian dollar as well the return of 'animal spirits' (lifting borrowing and inflation) and global factors.
- The Aussie dollar is expected to grind higher to around US97 cents by late 2014 and US99 cents in early 2015 before easing to US95 cents in mid-2015 and US91 cents by late 2015. Interest rate movements in Australia and the US will be important in influencing the timing of moves and levels reached for the Aussie dollar

Investment markets

- Corporate Australia is in strong shape, with businesses focussed on both containing costs and boosting revenues. Companies continue to record profits and they maintain cash at high levels.
- The challenges for Corporate Australia in 2014/15 include the vagaries of local politics, downward pressure on margins, the high level of the Australian dollar and even the weather – as utilities and clothing retailers have found out with warmer-than-usual autumn and winter conditions.
- CommSec expects the All Ordinaries index to be at 5,700 points at end-December 2014 and 6,000-6,200 points in June 2015.
- Home prices are currently growing nationally by around 10 per cent, but annual growth is expected to ease to around 5-7 per cent over 2014/15 as more houses and apartments are built and trim excess demand.
- Total returns on shares and residential property are expected to grow by 10-15 per cent over 2014/15 while returns on bonds are likely to be closer to 0-5 per cent.

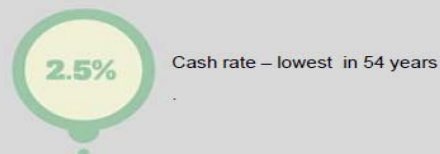
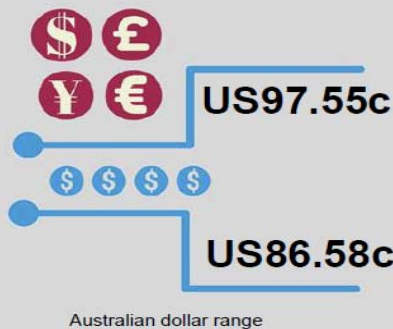


- The bottom line is that investors need to maintain research on asset class performance to ensure that they aren't missing out on returns in high-performing markets.

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Economic growth	2.75-3.25% in 2013/14	2.75-3.00% in 2014/15
Inflation	2.50-3.00% end 2014	2.50-3.00% mid 2015
Unemployment	5.50%-6.00%, end 2014	5.50-6.00%, mid 2015
Cash rate	2.50-2.75%, end 2014	2.75-3.25%, mid 2015
Sharemarket (All Ords)	5,700 points, end 2014	6,100 points, mid 2015
Australian dollar	US97c end 2014	US95c mid 2015

2013/14 : Facts & Figures



Sources: Iress, Reuters, ABS, RP Data

