Ausbil Investment Markets

Report

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International economic review

Economic Review

Donald John Trump was inaugurated as the 45th President of the United States, pledging to "put America first". Not since the 1920's has the Republican Party enjoyed a clean sweep with majority control of the White House, Congress, the Senate, State Legislatures and Governorships, and in the near term, the US Supreme Court. The US Senate Democrats outlined a plan for increasing public infrastructure by US$1 trillion over the next decade, funded by yet unspecified tax changes. This represents an important opening step in congressional negotiations over the boost in infrastructure spending. Financial markets are underestimating Trump's determination to honour his campaign promises to drive change in the US.

To date, Trump has signed the following Presidential Executive Orders:

- Withdrawing the US from the Trans-Pacific Partnership accord.
- Re-negotiating the North American Free Trade Association Treaty.
- Advancing construction of the Keystone XL and Dakota Access oil pipelines.
- Expediting environment approvals on high priority infrastructure projects.
- Freezing federal employment hiring, except for the military.
- Suspending the US refugee program for four months and banning for three months entry into the US of nationals from Iran, Iraq, Libya, Somalia, Sudan, Syria and Yemen.

The post US election 'reflation' thesis is the investment strategy for the medium term. The Dow Jones Industrial Average surpassed the 20,000 index level, driven by expectations of expansionary fiscal stimulus in major advanced economies, starting first in the United States. Fiscal expansion is forecast to generate faster US and global growth, with the emerging/developing economies expected to accelerate, benefiting from rising commodity prices.

The World Bank and the International Monetary Fund (IMF) released their World Economic Outlook reports in January 2017. The IMF is forecasting global activity to accelerate to 3.4% in 2017 and 3.6% in 2018, from a sub-par 3.1% likely outcome for 2016. Underlying the strengthening outlook is the projected fiscal stimulus in the United States and the pick-up in emerging/developing economies. US growth has been revised up to 2.3% (previously 2.2%) in 2017, and up to 2.5% (previously 2.1%) in 2018, while the euro area is expected to grow at 1.6% in both years, with Germany and France leading the gains. Emerging market growth is expected to accelerate to 4.5% in 2017, then to 4.8% in 2018, from 4.1% in 2016, as Russia and Brazil emerge from recession. Chinese growth has been upgraded to 6.5% (previously 6.2%) in 2017 on expectations of continued government stimulus spending. UK growth for 2017 has been revised up to 1.5% (previously 1.1%), reversing the initial post-Brexit forecast reduction in growth.

Although the balance of risks is viewed as being to the downside, there are also upside risks. Global activity could accelerate at a faster pace if policy stimulus turns out to be larger than currently forecast in the US or China. Negative risks include a shift toward protectionism under Trump's presidency, increased geopolitical tensions in Europe with Brexit negotiations, the upcoming elections in France and Germany, and a slowdown in China.

United States

The Federal Reserve has indicated that two to three rate hikes are likely in 2017. Fiscal policy is driving upgrades to GDP for 2017 and 2018. Input costs are accelerating and wages are rising to a 2.9% pace.

Europe

In the United Kingdom, Prime Minister Theresa May, delivered a 12-point vision for Brexit, but the UK Supreme Court dismissed the Government's argument that the PM could use its executive powers known as 'royal prerogative' to invoke Article 50 of the European Union's Lisbon Treaty, stating: "any change in the law to give effect to the referendum must be made in the only way permitted by the UK constitution, namely by an Act of Parliament." There was no approval required from the UK's devolved assemblies in Scotland, Wales and Northern Ireland before triggering Brexit. Elsewhere, inflation rose to a three year high, while PMI surveys pointed to strong start for the first quarter of 2017.

China

Fourth quarter GDP accelerated to 6.8%, generating an average 2016 pace of 6.7%, which was robust. Capital controls were tightened further on foreign exchange and pipeline inflation was seen to be accelerating.

International economic review

Japan
The Bank of Japan (BoJ) left monetary policy unchanged and extended existing lending programs by a further year. Given an improvement in the global economy and the recent Yen depreciation, the outlook report revised GDP growth forecasts higher to 1.4% in FY16 (prior estimate was 1%), 1.5% in FY17 (from 1.3%), and 1.1% in FY18 (0.9%). Core inflation for FY16 was revised down to negative 0.2% from negative 0.1%, while FY17 and FY18 were left unchanged at 1.5% and 1.7% respectively. The BoJ repeated that core inflation is likely to reach the 2% inflation target by the end of FY18.

Australia
Australian employment recovered strongly in the fourth quarter, concentrated in full-time and male sub-categories. Third quarter dwelling commencements were at record high levels, while house prices remained stubbornly high in 2016, with Sydney and Melbourne experiencing double-digit growth rates. The headline CPI annual rate was 1.5%, with a modest uptick in the underlying rate to 1.6%, which was in-line with the earlier forecast profile from the Reserve Bank of Australia.

Global Outlook

Global monetary policy divergence is in progress as the United States normalises interest rates over the medium term. The concept of the ‘neutral federal funds rate’ (estimated to be at 0% real and 2% nominal) will be the key factor driving monetary policy. The past year’s dis-inflationary offset from lower oil and commodity prices is quickly fading, and we expect to see the various forecast core measures of inflation consolidate well above the key 2% level. We expect the US Federal Reserve to hike rates by a minimum of 50 basis points in 2017. If activity and inflationary pressures build over the year, the Federal Reserve is expected to adjust its tightening trajectory with the unveiling and implementation of President Trumps’ tax cuts and expansionary fiscal policies on infrastructure. In Europe and Japan, negative deposit rates are expected to continue as Quantitative Easing programs are modified and tapered gradually.

Australian Economic Outlook

Australian Economic Outlook

Australia is amid an ongoing structural transition with the decline in mining investment nearing completion and exerting a significantly lesser drag on activity. We expect the modest upswing in non-mining business investment to support activity with real GDP growth around trend, which is estimated at 2.8%. Low nominal wages and flexibility has allowed businesses to expand their workforces to date, but we are fast approaching the point where the next stage should be to embark on private business investment. The extremely low cash rate is providing ongoing support to aggregate demand and the low Australian dollar is driving domestic production, especially in the services sector. Core inflation is undershooting the low end of the target band, with benign wage inflation outcomes at 2%. Business confidence is consolidating higher and sustaining an optimistic profile, which is similar to the period from 2002 to 2008. Consumer confidence has sustained a favourable improvement back into optimistic territory through 2016. Employment growth, despite being slow and in the part-time category, is expected to see the unemployment rate remain well below 6%. This in turn is supporting household income and private consumption. Housing remains the key beneficiary in the near term, but the boom may have peaked late last year. Construction, net exports and infrastructure spending are important drivers for growth in the near term. Given we believe in sustainably higher oil and commodity prices, we expect the fair value for the AUD/USD exchange rate to average 0.78 for 2017 and average 0.80 for 2018. We expect the record low cash rate at 1.50% to remain unchanged for this year before gradual rate hikes commence in June 2018.

At the upcoming May 2017/18 Federal Budget there is the opportunity for fiscal stimulus to be pursued through the channel of infrastructure investment. This can be achieved by the Government committing to achieving a budget surplus on recurrent spending, while opening up the prospects for capital investment. Whether that option is pursed will be dictated by the Government's obsession with keeping the AAA credit rating and keeping the rating agencies at bay.

Notes

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