Monthly

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Economic & Market Commentary

– Month Ending August 2016

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The global economy has slowed in recent months, with growth in the key major economies of the US, Japan and the euro zone all sluggish. Growth for the US was 1.1% (annualised) in the June quarter, 0.3% for the euro zone and 0% for Japan (both quarter-on-quarter).

In its most recent report (19 July), the International Monetary Fund (IMF) reduced its world growth forecasts for 2016 to 3.1% (the same as for 2015) and to 3.4% for 2017 but these could be revised down even further if evidence of a pick-up does not soon emerge.

As the IMF noted in its report, 'most advanced economies continue to confront significant economic slack and a weak inflation outlook', which require 'a combination of near-term demand support and structural reforms to reinvigorate medium term growth'.

'Demand support' implies continuing expansionary monetary policy (low interest rates and, where necessary, 'quantitative easing') as well as other supportive measures.

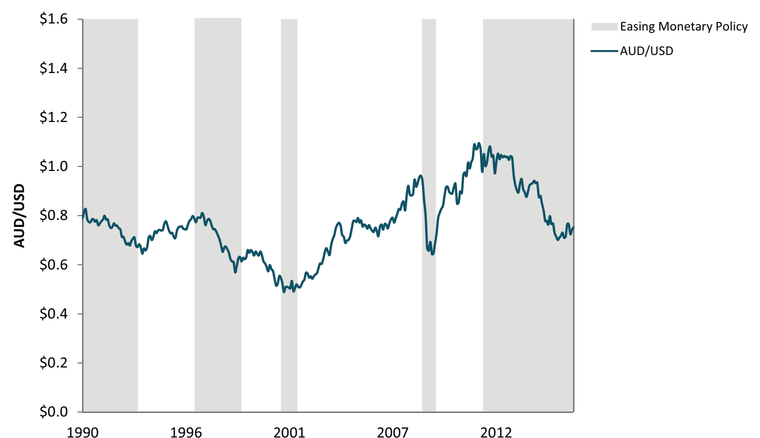
Despite this, however, the US central bank (the 'Fed') appears likely soon to raise official short-term rates above the current historically low 0.25%.

As Janet Yellen, Chair of the 'Fed' put it on 26 August, 'the case for an increase in the federal funds rate has strengthened in recent months' (mainly due to an improvement in the labour market), despite the fact that 'business investment remains soft and the appreciation of the dollar since mid-2014 continues to restrain exports'.

The IMF, on the other hand, notes that 'greater reliance on measures to support domestic demand, especially in creditor countries with policy space, would help reduce global imbalances while contributing to stronger world growth'.

This particularly refers to Germany, which is currently running a current account surplus of over 8% of GDP, while running a budget surplus (a contractionary fiscal policy), which is keeping domestic demand restrained.

Relationship between AUD/USD Exchange Rate & RBA Monetary Policy



Source: RBA

Until very recently, **the Australian economy** has been affected by an ongoing decline in its terms of trade, due to weak commodity prices.

However, the RBA index of commodity prices actually picked up somewhat in July and as a result, national income measures, which reflect 'the real purchasing power of income generated by domestic production' (Australian Bureau of Statistics) could also now be moving up once again after a long period of weakness.

With inflation low (up 0.4% for the June quarter and 1.0% for the year), the Reserve Bank (RBA) may need to cut interest rates again soon to help lower the $A, lift inflation and boost competitiveness (see chart).

Major share markets have been trending up since soon after the UK voted in a referendum on 23 June to leave the European Union.

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From 1 January to 30 August, market movements included rises of 7% for the US (S&P500), 9% for the UK and 3% for Australia and declines of 1% for Germany, 13% for China and 12% for Japan.

Valuations mostly remain fair and most share markets still appear to be fairly priced, especially compared with other sectors such as bonds and cash.

Major global government bond markets saw yields (interest rates) begin a severe downwards trend in late December, soon after the US central bank began to raise interest rates.

This was interrupted in February but began again in late May, taking yields close to historic lows by late July.

Overall, most bond markets continue to look expensive.

Fiducian's diversified funds are currently somewhat above benchmark for growth assets, including domestic shares, international shares and listed property. Exposure to fixed interest sectors is underweight, while cash weightings remain above benchmark.

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