Economic News January 2019

Investment markets started 2018 full of hope, with the global economy and financial markets performing well. Investment markets were supported by strong growth in the US and China as well as evidence of recovery in Europe and Japan, while President Trump's corporate and personal tax cuts helped drive US corporate earnings and market momentum. However at the end of 2018, investment markets were uncertain and nervous about the unresolved trade dispute between the US and China, confusion over Brexit, rising US interest rates, falling commodity prices and the US government shutdown.

Australians were also distracted by political instability and falling house prices in Melbourne and Sydney. With so much uncertainty about, it was easy to lose sight of the solid progress most economies had made.

Positive economic growth

The global economy grew at a steady rate of 3.1% in 2018. The World Bank estimates global growth will ease slightly to 3% this year and 2.9% in 2020 as central banks remove the monetary stimulus in place since the global financial crisis.

The US economy has continued its strong recovery, expanding by 3% in the year to September 2018. China's growth slowed to 6.5% (its lowest since 2010), as the trade dispute with the US began to bite. Australia once again, enjoyed a steady growth rate of 2.8% in the year to September 2018, after an incredible 27 years without recession. The fundamentals in the Australian economy are still sound with very low interest rates, strong corporate profits, inflation a low 1.9% and unemployment which fell to 5.1%.

Whilst retail sales (particularly leading up to Christmas) remained slow, consumers are still cautiously upbeat although low wage growth is hampering consumer confidence.

A closer look at Interest rates

The Australian dollar fell 10% in 2018 to finish at US 70c, due largely to US dollar strength and a widening of the gap between Australian and US interest rates.

The US Federal Reserve lifted rates four times to 2.5% but indicated there may be only two more hikes in 2019, not three as previously forecast, due to the slowing US economy. By contrast, Australia's cash rate finished the year where it started at 1.5%, which has now remained unchanged for some time.

The lower Australian dollar is good news for our exporters and should soften the impact of falling commodity prices, which have been impacted due to potential US and China trade wars.

Iron ore was down 3% while oil, copper, aluminium, zinc and nickel prices dropped between 16% and 19%. The one bright spot for local producers was wheat, up almost 20% in 2018.

Housing prices losing steam

After a period of very strong returns, Australian house prices have begun to fall due to tougher borrowing conditions led in part by the Banking Royal Commission. In Melbourne and Sydney, house prices have dropped between 10% and 15%, and analysts are predicting the falls to continue through 2019.

As long as unemployment stays low, it is likely that the decline in house prices will remain gradual, although clearly in some pockets, where there are high levels in indebtedness, there will be some distress. While Australia's high level of household debt is a potential source of fragility, it probably means the Reserve Bank of Australia will need to keep interest rates low for some time yet.

Looking ahead

The late investment market reversals of 2018 were driven by gloomy expectations rather than deteriorating economic data. Investment markets have been elevated for some time and it is normal to experience corrections in asset prices which is often accompanied by large volatile movements. Future performance will depend upon US interest rates, the resolution of trade tensions and the negotiation of a workable Brexit. Due to the recent correction in financial markets, most risk asset classes appear fairly valued although we expect volatility to persist for much of this year.

In Australia, uncertainty will persist until the Federal election is out of the way which could be held in May 2019. Hopefully we will see investment markets return to focusing on our solid economic growth, a strong corporate sector, resilient consumers, low interest rates and low unemployment.

A defensive portfolio stance remains justified

We have believed for some time that it is appropriate to defensively position investments. Most investment portfolios are: holding more cash than normal, remaining selective about the types of bonds to limit exposure if interest rates rise quickly, retaining a high exposure to unhedged global shares to take advantage of a falling Australian dollar, and employing private equity strategies to improve risk control and returns.

Other news

As previously advised, NAB announced last year the sale of their wealth business by the end of 2019, so that it can be managed as an independent entity to the bank. NAB has already sold part of its insurance business to Nippon and this transition was completed smoothly. We view this sale as a positive step and in line with current thinking in the field. Whilst we are still licensed through nab financial planning, we moved to a more independent structure over 4 years ago. For clients holding MLC investments, you will receive more communication about this as the year progresses.

If you have any questions or wish to discuss anything, please call us on 03 9544 1004.

Wishing you a very happy 2019,

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