

Economic Snapshot



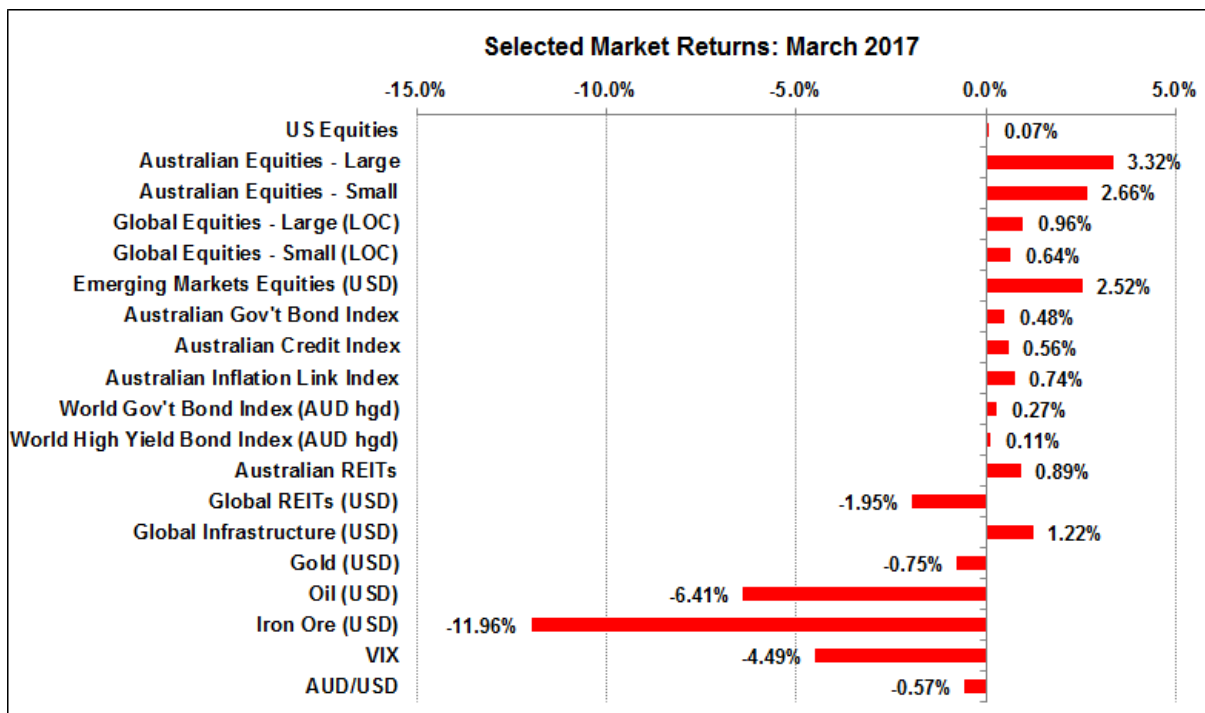
March- April 2017

Summary

The big picture in world markets for Australian investors is that latest data shows the Australian economy looking a bit softer, while the US economy continues to display positive momentum. In these circumstances it is not surprising to see the RBA leave the cash rate at 1.5% and the Federal Reserve in America lift its cash rate to nearly 1.0%. Australia is grappling with soaring house prices in Sydney and Melbourne but an overarching slowdown in the economy at large. Consensus amongst Economists is that the Fed is likely to lift the cash rate at least twice more this year and if so, we should see parity between the local and US cash rates for the first time since late 2000. That should put downward pressure on the A\$/US\$ which remains stubbornly high around US\$0.76. Despite the relative economic performance, the Australian equity market was strong in March. [Figure 1 below].

The UK has started the formal Brexit process which is expected to take at least two years. There is also increasing pressure to hold another Scottish independence referendum as the Scots voted to stay in Europe and feel aggrieved by the exit. Far-right parties in the Dutch election were soundly beaten with the return of the incumbent government, while in France, Emmanuel Macron looks like the front runner with the Le Pen threat not as significant as previously thought.

Figure 1: All equity markets were positive in March - particularly Australia



Source: Thomson Reuters

Australia

We have experienced further signs of softer economic conditions in Australia. The labour market report for February showed an unexpected decline of 6,400 in the number of people employed while the unemployment rate picked up from 5.7% to 5.9%. These are short term measures but cause concern for the RBA with interest rate decisions having regard for the balancing of the economy vs the property market rises. The fall in employment was driven by part-time jobs with full-time jobs increasing in the month. At the same time, the latest NAB Monthly Business Survey showed business sentiment slipping in February across a range of measures. The key Business Conditions indicator unwound all the sizeable gains reported for January. The inflation components of the Survey remained subdued.

Although these and other indicators do not suggest the Australian economy is about to roll over, ***they nevertheless paint a picture of fading economic momentum rather than improving national growth. This is in marked contrast to the United States and some European countries where economic conditions are clearly improving.*** These domestic conditions contributed to the Reserve Bank's decision to keep cash rate at 1.5%.

The tone of the latest RBA press release announcing the cash rate decision was a little less optimistic than some of their previous statements. Financial markets immediately interpreted this as a sign that interest rates would not rise in Australia as quickly as previously expected and the Australian dollar slipped back below US\$0.76 in response. Moves by banks to lift selected mortgage rates and by APRA to further restrict speculative lending for housing both contributed to financial markets re-assessing the need for the Reserve Bank to lift the cash rate any time soon.

Despite significant regional difference across the country, the housing market continues to attract a lot of attention, especially in Sydney and Melbourne. The RBA and APRA are increasingly concerned about the debt burden households are taking on with property purchases and their sensitivity to inevitable future interest rate increases. Although the authorities' latest measures to moderate speculative housing purchases are well-intentioned, history suggests they may have little real impact. Much more dramatic action would be required to curb the demand for housing and there is little chance any government in Australia would go down this path.

The higher mortgage rates recently announced by banks fuelled expectations of higher bank profits which in turn helped push the Australian equity market up in March. AREIT's and industrials also performed quite well in the month, with the former helped by falls in bond yields. Nevertheless, it seems out of step that our equity market should outperform the rest of the world while our economy is doing the opposite.

USA

There was mixed news from the USA in March with some positive economic statistics contrasting with President Trump's latest setback in pursuing his reform agenda. The labour market remains in good shape with a further 235,000 jobs added in February and the unemployment rate edging down a touch to 4.7%. Wages growth remained subdued around 2.5%, which is about the same pace as consumer price inflation. Indicators of manufacturing activity and consumer sentiment both remain strong. In this environment the **Federal Reserve took the opportunity to lift the cash rate by another 0.25% to a new target range of 0.75% to 1.0%**. This was the third interest rate move since December 2015. Financial markets expect further rate increases in the US over the coming year. There still appears to be a range of mixed opinions among Fed officials about just how much tightening is required in the near term.

In contrast to this, President Trump's failure to get his legislation repealing Obamacare through Congress as easily as he might have expected raised the question of whether he will be able to enact other key parts of his policy agenda. In particular, the proposed tax cuts and infrastructure spending plans may not be as positive for the economy as has been hoped. This is potentially a risk to equity markets which really need the Administration to deliver on economic stimulus in order to maintain the current pace of positive economic momentum that the markets have priced.

UK

In the UK Prime Minister May has announced the start of the Brexit process which is expected to last the next two years at least. Amidst the debate about whether or not Europe will take a hard line with the UK, Scotland's First Minister has taken the opportunity to call for another independence referendum. The Scots were aggrieved by the decision to leave Europe and the Scottish Nationalist Party which routed the Tories and Labour in the last general election undoubtedly sees this as the moment in History for Scotland to achieve its independence. This could prove to be a distraction for UK equity markets and the currency which needs to strengthen through trade agreements and a stronger economy post Brexit.

Europe in General

In France the election campaign continues with Emmanuel Macron the leading contender. Indicators suggest that Marine Le Pen will not poll as well as some commentators had thought. Meanwhile in Holland the government was returned favourably in a significant repudiation of the far-right parties. The growth in far right politics across Europe remains an ever present threat and is fuelled by the refugee crisis which has no end in sight.

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