Economic Update

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By Ron Bewley*. Brought to you by PATRON

Within this month's update, we share with you a snapshot of economic occurrences both nationally and from around the globe.

The rally that keeps on giving

- ASX 200 and Wall Street surge

- United States (US) economy stronger than expected

- Japan is still performing strongly

We hope you find this month's Economic Update as informative as always. If you have any feedback or would like to discuss any aspect of this report, please contact your Financial Adviser.

The Big Picture

Most of the action for this year centres on the end of October and the beginning of November. The US Federal Reserve will announce its new balance-sheet-repair policy, Trump will nominate the new Fed chair, Japan and the UK Central Banks are planned to make big statements. Plus we get the usual US jobs data and the China manufacturing data.

The year-to-date on the ASX 200 has been quite strong at +8.0% (including dividends but not franking credits) and its October total return was well ahead of the major markets – except for Japan's Nikkei.

At last our market is on the move but our economy isn't. Our Retail Sales posted a miserable -0.6% for the month and inflation was a meek +0.6% for the quarter or 1.8% for the year. Professor Ian Harper – new to the RBA board – stated that he isn't ruling out a rate cut – and neither are we. Inflation just isn't strong enough to warrant the rate hike many are predicting.

Our jobs data were not bad, even if the unemployment rate did go up a notch to 5.5%. But we should remember it was as low as 4.0% in 2008 and 5.0% in 2011 after peaking at 5.8% in between.

It is hard to know what impact the citizenship debacle will have on politics but it can't be good for our economy.

US monetary policy is going through a transition but it has been so well flagged, it is hard to predict more than a modest bout of volatility. The new Fed chair is expected to continue current policy.

The hurricanes had a major impact on jobs as reported at the start of October – a loss of -33,000. So, as people can get back to work – and there is some repair work in train – we could get a bumper result on the 4th November.

US economic growth for Q3 came in at an impressive 3.0% for the year, with unemployment dropping to 4.2%. The chance of one last hike for 2017 has gone up to 80% - as priced by the market. But the Fed's dot-plots still show their expectation for rates is still well above those priced by the market for 2018 and beyond.

US consumer confidence just came in at the best read since the year 2000!

Japan is still going strong with its third consecutive month of double digit growth in exports. The world economy is moving.

Prime Minister Abe got re-elected with a 'super majority' based on Japan's growth. He has the power to keep growth policies on the front burner.

Even the UK is doing well. Inflation came in at 3.0% and GDP growth at 0.4%. That should be enough for the Bank of England's Mark Carney to raise rates at the start of November.

And China continues its strength. CPI inflation was 1.6% and its producer price equivalent (PPI) came in at 6.9%. It wasn't long ago that PPI was more like -6%. And the manufacturing index at 51.6 was well above the 50 needed to see continued expansion.

The ECB has vowed to keep stimulus going to at least September 2018. Except for us, the world economy is doing great. At least that means we are getting global support for now. Imagine if the world economy was not as strong?

Asset Classes

Australian Equities

The ASX 200 enjoyed a wonderful October. It gained 4.0% and most sectors enjoyed the spoils. Although Property and Telcos gained strongly they performed well below the average.

As we enter reporting season, new paths may be charted. Bad news is usually drip fed during the prior 'confessions season' in the month before. So far it looks like our market can grow into the year end – without any help from Santa.

We see capital gains for the ASX 200 continuing at around an average rate of just above 5% pa. With dividends and franking credits, the total returns forecast creeps comfortably into double digits for the next 12 months.

Foreign Equities

The S&P 500 has not recorded one negative month of capital gains in the last twelve months. Nice work if you can get it. The World (MSCI) index performed nearly as well – just one negative month but only a loss of -0.1% in August!

As far as FY18 year-to-date is concerned of all of the seven word indexes we track all are well in the black. All parties end sometime so how long have we got to go?

Small negative surprises can come at any time and largely cannot be predicted. However, we do not yet see sufficient over-pricing to expect a correction any time soon. Until bond rates rise significantly, investor's cash needs a home and equities is the main game in town.

Bonds and Interest Rates

The RBA was on hold again and it is likely to stay that way for some time. There are some chinks in our armour – notably in retail sales and inflation – making rates going down still a serious consideration.

The market expects the Fed to raise rates in December but we think the chance is much less than the 80% currently being priced in. There is nothing in the data to require a move and there is so much going on. We would favour them staying on hold for a while longer.

Other Assets

Oil prices had a strong month after the Saudi Crowned Prince came out in favour of stability in the oil market. Brent oil is back above $60 / barrel for the first time in about two years.

Copper, a bellwether for industrial growth, was up 5.8% in October. Our dollar was down -2.1% on the month.

Regional Analysis

Australia

Politics continues to muddy the waters as the citizenship debacle and its impact on the government unfolds.

Employment data continued to be solid but there is a lack of other data to justify its continuance. Retail sales have become a real problem. The last -0.6% followed a dismal 0.0% the month before.

China

Consumer and producer price inflation are solid in China. The new politburo has been sworn in leaving the President with even more power.

US

The remarkable result for the month was the +3.0% growth for the USA. After two big hurricanes, only 2.5% was expected but there was a big build-up in inventories. Is business expecting a big tax-cut fuelled surge?

Consumer confidence was expected to come in at 121.6 so the read of 125.9 really caused some excitement. That's the best number since 2000!

Europe

Brexit may be a problem but UK data keeps rolling along. The Bank of England looks almost certain to raise rates for the first time in many years when it meets on November 2nd. Growth was a respectable 0.4% for the quarter but inflation – at 3.0% - is a number most developed nations can only dream of. The top of the range hence start tightening!

The ECB announced its policies for the next twelve months – which is essentially no change. The Catalans (home to Barcelona FC) caused a stir by voting to exit Spain – so PM Rajoy sacked them all! No one can afford splinter groups trying to exit the EU. Scotland and then Brexit were about as much as the EU can handle. It probably means the EU will play even harder hardball with Britain – and anyone else who looks to be dithering on the fringe.

Rest of the World

North Korea seems to be less in the news so the sanctions might be working.

The Japan economy is surging and Japan has re-elected Abe for four more years with a 'super majority'. That gives him the power to try and change the constitution so he can build a defence force to protect Japan from North Korea.

New Zealand got an unexpected result in its election – swayed by which way Winston Peters leant. Does that mean more instability in the region?

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