1st February 2017

Woodhall's Wrap

Ron Bewley PhD, FASSA

The economic world has changed – at last

Trump has hit the ground running
Australian economy is struggling
China may again save us!

The Big Picture

A fascinating economic experiment is taking place. The only major economy than can reasonably be described as performing strongly is China. The US, UK and a few others are growing modestly. We are certainly in the 'could do better' basket for our report card.

After nine years of being stuck in a groove, it didn't look likely that western economies were going to spring into action anytime soon. But then along came Trump – a non-politician. His promise in simplistic terms was to do something different. He has certainly started off the way he said he would – signing executive order after executive order.

The markets have certainly been inspired in the last three months by Trump's confidence. Wall Street has repeatedly hit new all-time highs. Even the ASX 200 has witnessed strong growth since the presidential election.

Plenty of people have jobs here and in the US. It's just that they're not as well-paying jobs as they used to have – and many more are now part-time. As a result, there is little demand pressure to raise wages or consumer prices.

What are we missing? The business confidence to invest! There are two major factors that determine investment decisions: the potential demand for the output; and the cost of the investments.

There have been no flags waving for potential demand for nine years. So Trump aims to cut corporate taxes to make investing cheaper, and kick start potential demand by flagging big infrastructure projects jointly funded by the public and private sectors. The plan seems to have legs but nothing is certain in this world.

The US economy is starting from a low GDP economic growth number of +1.9%. Not bad but it is the slowest growth since 2011. That's actually good because it is easier for the next few numbers to show an improvement which, rightly or wrongly, might be attributed to Trump. And if that scenario eventuates, the snowball could gain momentum on business confidence.

The downside is that the snowball could get out of control in a year or two and lead to uncomfortable levels of inflation. The US Federal Reserve must become fleet of foot to raise rates at the right time. Too soon and the impetus might fizzle; too late and

Woodhall Investment Research Pty Ltd (ABN 17 141 486 160)

General Advice Warning: This note has been prepared without taking account of the objectives, financial situation or needs of any particular individual. Any individual should, before acting on the information in this note, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice. Past returns are no guarantee of future performance.

they create a big problem in trying to control an overheated economy.

So why is the media and public backlash to Trump so great? Could it be that there are many vocal sore losers than normal? In every election, the opposition person or party also get a lot of votes – just not quite as many as the winner. In Trump's case, he appealed to the less well-off groups. The educated and/or left leaning media and other disenchanted groups have better access to platforms for debate.

The blue collar workers in the US never had much of a voice – until they put up with an extended period of being worse off – and Trump is their knight in shining armour.

There is a very reasonable chance that the US economy will start to grow strongly again and take the world with it. The UK just posted the best current growth figure of 2.0% in western economies.

Australia should benefit from a strong China and US. Commodity prices might be supported, or even grow, but we can't live off resources forever. At some point we have to restructure our economy. We need tax cuts and infrastructure programmes like Trump. All we seem to have on offer from either side of politics are promises of tax hikes. Of course, in the short run, the deficit would increase but from good (infrastructure) debt – not bad (recurrent) debt.

Asset Classes

Australian Equities

The ASX 200 looked set to post a modest gain for January but it faltered in the last couple of days of January. But after the previous three months, a breather is perhaps welcome.

The resources sectors of Energy and Materials saved the day for us. Iron ore and copper prices made good gains on optimism about China. Australian resources companies are widely tipped to perform well in the upcoming February reporting season.

In the month before reporting – known as the 'confession season' – a number of companies experienced sharp prices movements – up or down – on the slightest of unexpected news.

Companies like Bellamy and Brambles lost more than 10% in one day on their share prices. Perhaps less well publicised were the big gains – like CSL, and Resmed.

The forward guidance given by companies in reporting season will not really have had time to have benefited from assessing any Trump-led impact. We'll have to wait for that.

Australian banks did really well in Q4 of 2016 but stumbled in January as investors realised that prices had run too hard. Unlike in the US, there is not a lot of change in the wings to help this sector. But dividends look largely safe and growth may come later.

Foreign Equities

Wall Street enjoyed a good January. The Dow Jones index broke through 20,000 and stuck for a couple of days. All four major indexes hit all-time highs on the same day!

The London FTSE staged a massive rally of consecutive daily gains. Brexit does not seem to be worrying UK investors.

We continue to think overseas markets will have a better 2017 than the ASX 200. Nevertheless, diversification across domestic and international markets still is wise

Bonds and Interest Rates

There should be little doubt that global rates are on the way up. The question is – how quickly? We think less so than many commentators because we think it will take time to put expansionary plans into action. And, of course at home, we still need cuts.

Macquarie Group reaffirmed its call for two rate cuts at home on 2017 but the consensus if for rates on hold until 2018.

Other Assets

Certain commodity prices (like iron ore and copper) continued to strengthen in January and our dollar (against the US) appreciated. Oil prices were down slightly but are well up on this time a year ago.

Regional Analysis

Australia

Our employment data released in January did nothing to dispel the feeling that our economy continues to struggle. Full-time employment was down -34,000 jobs on the year when maybe

+100,000 jobs were needed to allow for population increases.

The Bureau of Statistics pointed out that the annual change in total employment (including part-timers) was less than half of the average over the last twenty years.

Our inflation read missed expectations on the downside. Perhaps the only bright spot was data on resources trade which might save our bacon for the next GDP read.

China

China continues to post solid economic data. China even raised interest rates on 6 and 12 month loans to slow down its economy!

The latest Retail Sales figure was +1.9%, which was ahead of expectations, and economic growth was on target at +6.7%. The IMF upgraded its China GDP forecasts to +6.5% from the +6.2% forecast published last October.

USA

No one can be sure what Trump is really planning but the 'old political system' certainly was 'broke'. Some of his executive actions seem over the top but, perhaps, he needs everyone to sit and take notice. The world needs a new dawn and nobody before solved the problem.

All of the early short-term indicators point to an energised US economy. True – there are many unhappy folk – but Trump has surrounded himself with people who were mega-successful in their own rights – and not just a bunch of people getting the nod for services rendered.

Europe

The doomsayers again got caught out. The UK is not a disaster in a Brexit world. Indeed its economic growth in Q4 2016 was better than anyone other country in the Western World.

There were thoughts by some that a Brexit mentality would sweep Europe and cause chaos. That didn't happen either.

Rest of the World

Trump's temporary ban on travel from certain Middle Eastern and African countries to the USA causes angst among many – but the main ban is only scheduled to last for 90 days.

North Korea is still huffing and puffing over its nuclear programme. That's too difficult a problem to assess in en economic update.