Investment Report – August 2012

In mid July, the International Monetary Fund (IMF) released a rather pessimistic update on growth prospects for the world.

The IMF expects the world economy to remain soft for the remainder of 2012, as weakness in developing countries and Europe's sovereign debt crisis continue to stifle the global recovery. The IMF trimmed its forecast 2012 growth rate to 3.5% overall, warning that Europe's debt crisis continued to pose a significant risk. The estimate for growth in the UK was slashed to just 0.2% (behind France on 0.3%) and other growth rates were clipped for some of the big emerging markets. The IMF argued that further progress on banking and fiscal union must be a priority for the euro's leaders and warned that things could get worse in the US, if the government did not divert course from the looming "fiscal cliff" of tax rises and spending cuts in 2012/13. The Australasian economies are faring relatively well in this low growth environment, though.

Europe

Europe and its on-going fiscal and banking crisis remain the dominant theme, and main course of uncertainty, for markets. The June summit of European leaders made some progress but a complete solution remains elusive. Attention has now switched from Greece, which looks like a lost cause, to Spain and Italy. Spain is struggling to avert a fully-fledged sovereign rescue after its borrowing costs spiralled out of control in July. Confidence has evaporated since Germany effectively blocked plans for the EU bailout machinery to recapitalise the Spanish banking system directly, as announced after the EU summit deal in June.

In late July, ECB President Mario Draghi said that "the ECB is ready to do whatever it takes to preserve the euro and believe me, it will be enough." His statement lifted global sharemarkets in the late part of July.

USA

Steady growth still remains elusive in the US. Activity and employment data has softened although housing has shown some life. New US home construction rose in June to the highest level in almost 4 years, indicating that the residential real estate market is gradually strengthening even as other parts of the economy are faltering. Record low mortgage rates and cheaper properties are luring buyers back to the secondary market. Gross Domestic Product (GDP) growth in the second quarter to June for the economy slowed to an annualised rate of only 1.5%, as consumer spending eased. The unemployment rate remains at 8.3%.

Federal Reserve Chairman Bernanke states that he stands ready to apply further stimulatory policies to the economy later in the year, if needed. This is looking increasingly likely, and indeed is anticipated by the markets.

China

The Chinese economy continues to slow but lower recorded inflation numbers there means there is scope for even further monetary and fiscal stimulus, if need be. In the June quarter, China's economy grew at the slowest pace in 3 years as investment slowed and demand fell in key markets like the US and Europe. GDP rose by 7.6% pa in the second quarter, which is lower from the 8.1% pa growth in the previous 3 months.

China's manufacturing statistics lagged further in July, growing by its slowest pace in eight months on weakening export and domestic demand, despite other signs that Beijing's efforts to revive growth might be taking hold.

The Chinese authorities are well-placed and determined to meet their minimum target of 7% pa growth. Historically, they have consistently managed to produce a GDP growth rate that surpasses their predictions. Even a Chinese GDP slow-down to 7% is likely to be manageable for the global economy. China is now 40% larger than it was in 2008 and hence its growth rate can be 30% lower (i.e. 7% now versus 10% then) for it to make the same contribution to global GDP growth.

New Zealand

The rate of activity growth in New Zealand is still modest and mixed across sectors and regions, but it looks to be slowly improving in a sequential sense. Furthermore, while inflation pressures are currently benign, skill shortages are growing and there is less spare capacity in the economy than widely acknowledged. Annual inflation now stands at 1% pa, which is at the bottom of the Reserve Bank's target range. New Zealand consumer confidence is slowly rising along with spending and house prices.

Australia

Business confidence and conditions fell in the June quarter as a strong Australian dollar and the European debt crisis cancelled out the gains from several recent cuts in official interest rates. The statistics show that, as a proportion of nominal GDP, building activity is close to a 35-year low. Outside mining, Australia is in the midst of a downturn in residential, commercial and public sector infrastructure activity. Home prices in Australia have fallen 5 – 10% from their peak levels (compared with 15 – 20% in the UK and 30% in the US).
The lack of internal activity is not being helped by state and federal governments, whose infrastructure spending has all but dried up and the pipeline for new projects is woefully short.

Summary

In this low growth scenario, we expect interest rates to stay lower for longer. Most commentators now do not expect interest rates to rise in New Zealand until mid-2013, so bonds will remain a safe haven for some time yet. Unfortunately, the supply of new, good-quality issues to the market is still very low. Shares have been volatile in recent months but companies with strong balance sheets and the capacity to pay, and even increase, dividends have done relatively well in 2012 to date.

Information supplied by JMIS Ltd, Independent Investment Consultant to Select Wealth Management. The above article is a class service and is not personalised advice. For more information on how this may affect you please contact Peter. Peter's disclosure statement is available free of charge upon request.