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### Escalating trade tensions

Trade disputes continue to play a major role in the outlook for global growth and the impact that tariffs are having on the US consumer. China retaliated to the US, placing tariffs on imports from the US, only for the US threatening to increase tariffs on the remaining \$300 billion of China imports. What will ultimately happen on the trade front is hard to predict but it is having an effect on business sentiment and activity and in recent months growth forecasts for the US have been downgraded. Weakness in regional manufacturing surveys suggest the national manufacturing ISM decreased in June and is in danger of falling below 50pts. This is significant as this would be viewed as contractionary for the economy. Some of the trade concerns were deescalated at the G20 meeting in late June as Trump announced they would delay any further increases as they work towards an agreeable solution.

Trade tensions are also impacting China as economic data has taken a turn for the worse. Figures for May showed growth in industrial output slowing to 5.0% year on year, a 17-year low, as output of automobiles and computer equipment saw a sharp slowdown. Then in June Huawei announced that the US blacklisting of the company had contributed to a 40% month-on-month fall in sales of its handsets in May, forcing the company to downgrade its sales forecasts by around US\$30 billion.

The OECD estimates that if the tariff increases go ahead US GDP will fall by 0.8% by 2021, while Chinese GDP will fall by 1.0%. China does have the ability to stimulate the economy with the People's Bank of China (PBOC) benchmark interest rate at 4.35%. However, this would be a reversal of earlier attempts by the government to make economic growth less dependent on debt.

### Interest rates to go lower

In 2018 the US increased the fed funds rate to 2.25%-2.50%. This stance has now changed and if some of economic data released points towards a slowing economy, and the tariffs imposed start to weigh on growth, there is the potential for a 50-basis point cut in August and a total of 100 basis points cut by the end of 2019. This would potentially remove the scenario of an inverted yield curve; which markets view as a precursor to a potential recession.

In June both the Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand (RBNZ) did not cut interest rates. What they did do is emphasis that the global outlook is slowing, and risks have heightened. The RBA concluded there is more capacity in the Australian labour market than previously thought. Unemployment recently lifted to 5.2% and the RBA believe this needs to be below 4.5% to achieve its employment and inflation targets.

At the time of writing the RBA announced in their July 2nd meeting a cut of 0.25% taking the cash rate to a new low of 1%. The RBA Governor Philip Lowe suggested one rate cut alone would not be sufficient to boost economic growth as inflation continues to be below the targeted 2-3% range. Dr Lowe also noted, with wage growth still stubbornly low, the outlook for household consumption remained uncertain.

The RBNZ comments in June were not too dissimilar to the RBA's June's comments saying, "a lower OCR may be needed over time to continue to meet our objectives". The outlook for employment and inflation was said to have weakened, further supporting the view of a future rate cut.

Currently NZ interest rates are at all-time lows with the OCR at 1.5% and the NZ 10 yr Government bond at 1.57%.

The limitation that the RBA and RBNZ have in using interest rates to stimulate growth and achieve their targets is that the starting point for interest rates is at historic all-time lows. There is little evidence to suggest that lower and lower interest rates successfully generate either higher inflation or real growth outcomes. What we can expect is the theme of lower for longer.

### Europe

Europe's anticipated long-awaited rebound continues. Growth indicators are lacklustre and low inflation has the ECB pushing rate hikes further into the future. As a sign of a lack of growth there is nearly US\$13 trillion of bonds trading at a negative yield with a large portion of this European. People are prepared to invest money now in the anticipation of getting less back in the future!

Brexit uncertainty, political turmoil in Italy and the ongoing trade tensions between US and China drags on the region's business confidence. Low interest rates and monetary stimulus should provide some tailwinds with GDP forecast to be 0.4% in 2019. If trade tensions do ease there is some optimism for the region as company valuations are at reasonable levels.

Brexit continues to weight on the British economy until the new prime minister is able to secure a deal with Europe, or a second referendum is called.

### Summary

Uncertainty about trade and populist policies continues to weigh on market sentiment and business confidence. Some economic indicators are weakening in 2019 from the relatively positive position in 2018.

Globally central banks have a bias towards interest rate cuts as bond yields continue to fall. With further rate cuts anticipated sharemarkets continue to edge higher. US-China trade tensions need to come to some sort of favourable conclusion for positive sentiment to return and support the current company and market valuations.

If interest rates continue to fall and central banks continue to demonstrate a willingness to set accommodative monetary policy to support slowing economies, we would expect sharemarkets to move higher. If this does not happen our view has not changed of being moderately cautious as heightened uncertainty present risks to the downside.