ADVANCE
ASSET MANAGEMENT

VOLATILE RECOVERY

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The continued Chinese slowdown and Greek situation played on markets over July though stronger second quarter data from the UK and US had indicated the chance of rate rises in September. Dramatic drops in the Chinese share market and currency depreciation in August have continued to heavily influence markets since then. Tim Rocks, Head of Market Strategy and Research, considers the activity in July and its ongoing influence on global economies.

AUSTRALIA

The Australian economy performed broadly as anticipated in July with moderate but positive growth and contained inflation. However, the equity market suffered losses due to growing concerns about the Chinese outlook and falls in commodity prices. The Reserve Bank of Australia (RBA) left interest rates unchanged but made clear in its August Statement on Monetary Policy that it would reduce rates further if needed.

US

Expectations that the US Federal Reserve (Fed) would begin raising interest rates in mid-September increased as a result of the semi-annual testimony by Fed Chair Janet Yellen to Congress, the Federal Open Market Committee July post policy statement, second quarter GDP results and July payroll data. The Fed will start raising rates if incoming data (particularly labour market and inflation) suggests further upside momentum, although the recent concerns about Chinese growth may cause a delay.

JAPAN

The Bank of Japan (BOJ) kept policy unchanged and is continuing its quantitative easing program across the country. The good news was that business surveys are positive and pointing to an improvement in investment, but the ongoing concern for the BOJ is that inflation remains very close to zero and any further weakness in Chinese growth could push Japan back into outright deflation.

EUROZONE

Despite the recent and heightened uncertainties surrounding Greece, Eurozone data released in July suggests the region's recovery is continuing to unfold and indeed strengthen. While the partial resolution of the Greek situation in July meant a more promising outlook for the Eurozone, the European Central Bank (ECB) has stated it is ready to add to its existing quantitative easing program if economic and financial conditions deteriorate. The ECB will factor any impact from the ongoing Chinese slowdown along with any change in the Greek situation while monitoring the region.

UK

The second quarter saw a bounce back in growth for the UK and expectations that inflation will gradually pick up over the coming year. This suggested an increased likelihood that the Bank of England (BOE) will start to raise interest rates sooner rather than later, dependent on ongoing recovery and the impact of market activity from China or Greece. Any rise in official interest rates is likely to be slow and data dependent.

CHINA

While second quarter data had indicated that growth was higher than the expected 7%, there has been evidence to suggest momentum has eased. The Chinese government has continued to seek to manage its slowdown and has also been impacted by dramatic declines in its share markets. Expectations of further policy stimulus remain, especially given continued volatility in the share market and the decision to depreciate the yuan.

TIM
ROCKS

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What are the market uncertainties concerning the RBA in its outlook for the Australian economy?

Inflation is expected to have little bearing on RBA policy decisions given subdued domestic demand and increased labour market slack which has muted wage pressures. Inflation has also been low in most major trading partners, reducing the chance of pressure from global sources. As result, there are a few other uncertainties that the RBA will be monitoring for its policy decisions.

Global growth, in particular in China, is one of the biggest concerns for the RBA. It sees a number of downside risks for the Chinese growth trajectory and the implications of this for commodities demand. The RBA is also conscious of uncertainty surrounding the prospect of a US rate rise and the impact should it start to raise rates. Domestically, the RBA is focused on the degree of spare capacity in the labour market, and the outlook for both consumption growth and business investment.

What drove increased expectations that the US Fed will normalise interest rates in mid-September?

Janet Yellen, Chair of the Fed, addressed the prospect of normalising interest rates in her semi-annual testimony to Congress in July, commenting on the benefits of a gradual increase and improved prospects for the labour market. She noted that delays in normalising have been due to the continued subdued rate of inflation (a result of temporary factors like the strong US dollar and low oil prices). While July GDP and labour market indicators supported the case for a rate rise sooner rather than later, wages data have continued to be less encouraging and more recently, large declines in the Chinese share market have seen the Dow Jones also drop substantially. The ongoing impact of the Chinese slowdown and August inflation and labour market data will be key considerations for the Fed in determining when to raise official interest rates.

Will the Eurozone see further recovery now that Greece has agreed to key austerity and reform measures?

Business confidence rebounded in July off the back of the ECB deal with Greece. July manufacturing surveys and the second quarter ECB Bank Lending Survey results were encouraging and showed an increase in net demand by both businesses and households. These results also offer support for business investment, the housing market and consumer spending.

The ECB anticipated further recovery to be supported by its monetary policy measures, the decline in oil prices, the decline in the euro and progress made on fiscal and structural reform. That said, the Chinese slowdown has had a considerable impact on global markets in late August and there are concerns over the ongoing stability of the ECB deal with Greece given the resignation of Prime Minister Tsipras and upcoming elections to resolve government division over the deal.

How likely is the BOE to increase official interest rates before the end of the year?

The Governor of the BOE, Mark Carney, indicated in July that the time to act on raising official interest rates is getting closer while commenting that such an action would take around 18 months after implementation to take effect on inflation and the economy. The recent drop in manufacturing, due to the strength in sterling, is a concern and a key consideration for the BOE. Services is another key driver, accounting for nearly 80% of GDP, and the BOE will be mindful of any trends in this sector in determining whether to raise interest rates. As with the US, the BOE will also monitor the impact of the Chinese slowdown in determining timing for a rise in the official interest rate.

What are Chinese authorities doing to avoid a further economic slowdown?

China has seen softer economic data over the past few months along with continued volatility in its share market. The dramatic decline in the share market has also affected global markets. To date, the Chinese government has implemented a number of measures to support its share market and economy including monetary policy easing, exchange rate depreciation, reversal of changes to local government financing rules and an increase in funding for infrastructure. Given ongoing volatility in August, these are likely to be supported by further measures with a focus on continuing to stimulate growth. The New Silk Road initiative from China championing a range of infrastructure initiatives to boost trade will also assist the country through long term investment opportunities.

What does this mean for investment strategies?

Share markets have come under pressure as concerns over the Chinese economic outlook have grown. However, we expect investor concerns to be short-lived. The turmoil in markets has created a range of interesting opportunities and investment ideas. We expect that changes in policy will drive share markets higher over the next 12 months and be broadly supportive of corporate credit.

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