Economic Update April 2017

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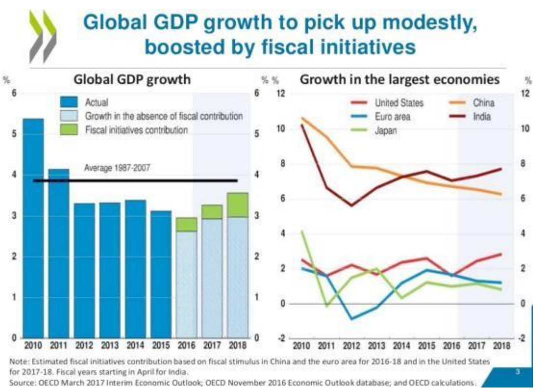
"If you have one economist on your team it's likely that you have one more than you'll need."

Warren Buffett

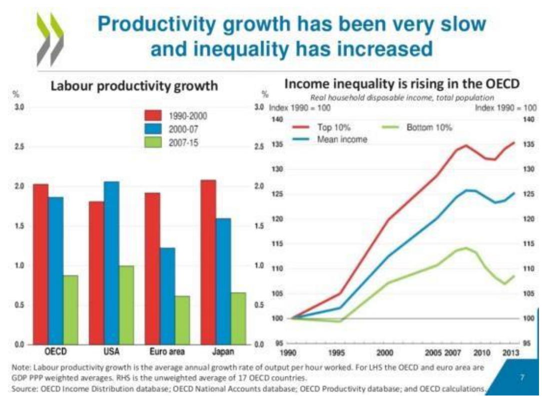
The Global Economy



The chart on the left shows that global growth is improving which is a good thing however it is just simply not enough which is not a good thing.

Global economic growth continues to improve but needs ongoing support from central bankers around the world. Confidence is increasing but remains fragile. Also productivity growth remains lack lustre and growth is not evenly spread. With Brexit underway and other countries in the Euro area talking in a similar vein, with Donald Trump, the president of the United States, the people have spoken as trust in government generally remains low around the world.

More importantly from an investment perspective, there is the disconnect between financial markets and the real economy. In short, asset prices are high compared to underlying economic fundamentals. An unexpected event could see asset prices "snap back" to more realistic levels.



The left hand chart shows declining labour productivity – not good. The right hand chart shows growing income inequality helping create dissatisfaction for low and middle income earners around the world.

Ongoing fiscal support by central bankers will be required until further notice. Economic growth is improving although it is slower than the 4% growth needed to meet economic demands and expectations. Interest rates however will likely increase although at a modest pace, at least for now.

Donald Trump sending missiles into Syria is a potentially serious issue for investors to watch. Although it is unlikely, as some internet jockeys contend, that this could lead to World War III, it will be interesting to see how Russia's Putin responds. His modus operandi is to stand by and wait as he weighs up his options and then hits back with a calculated response at a later date when it suits him. Anyway, global economic growth whilst fragile is heading in the right direction, even if there is a long way to go yet …

The United States of America

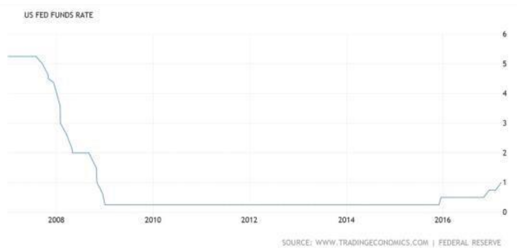
U.S. Annual GDP Growth Compared to Business Cycle Phases

Year	U.S. GDP Growth	Unemployment Rate (December)	Inflation (December Year-over-Year)	Business Cycle Phase
1929	NA	3.2%	0.6%	Aug peak. Oct market crash.
1930	-8.5%	8.7%	-6.4%	Contraction.
1931	-6.4%	15.9%	-9.3%	Contraction.
1932	-12.9%	23.6%	-10.3%	Contraction.
1933	-1.3%	24.9%	0.8%	New Deal. Mar trough.
1934	10.8%	21.7%	1.5%	Expansion.
1935	8.9%	20.1%	3.0%	Expansion.
1936	12.9%	16.9%	1.4%	Expansion.
1937	5.1%	14.3%	2.9%	May peak.
1938	-3.3%	19%	-2.8%	Jun trough.
1939	8.0%	17.2%	0.0%	Expansion.
1940	8.8%	14.6%	0.7%	Dust Bowl drought ended.
2007	1.8%	5.0%	4.1%	Dec peak.
2008	-0.3%	7.3%	0.1%	Contraction. Financial Crisis.
2009	-2.8%	9.9%	2.7%	June trough.
2010	2.5%	9.3%	1.5%	Obamacare. Dodd-Frank.
2011	1.6%	8.5%	3.0%	Expansion.
2012	2.2%	7.8%	1.7%	Expansion.
2013	1.7%	6.7%	1.5%	Expansion.
2014	2.4%	5.6%	0.8%	Expansion.
2015	2.6%	5.0%	0.7%	Strong dollar. Low oil
2016	1.6%	4.7%	2.1%	prices. Fed raised rate.

The above charts show a deeper economic contraction in the early 1930s compared to the Global Financial Crisis 2008 through 2011 and a more modest economic recovery over the last few years compared to the early to mid 1930s. Central bank intervention is one key difference between then and now.

The US economy by a number of measures appears to be on track. Economic growth is expected to remain between 2% and 3% although Trump is talking 4%. Unemployment by some estimates could drop to 4.5% in 2017. Inflation is tracking at 1.9% over 2017 and possibly 2% in 2018 and beyond.

USA manufacturing which is a key indicator for any economy is expected to increase at a slightly faster rate than the general economy which is good if it materialises. Growth is expected to increase by 3% over 2017 and possibly 2.8% in 2018. Although it is difficult to gauge, there is real evidence that "re-shoring" (businesses bringing their manufacturing factories back on shore once again due to technology advancements) might be helping to boost manufacturing in the future in the US.



Interest rates in the US are on the way up but as the chart shows they have a long way to go to get back to more normal levels.

Although supported by ongoing central bank intervention and with a large amount of debt to service, the debt remains manageable for now and the American economy heading in the right direction.

The Eurozone

Euro area | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.4 %	Dec/16	0.4	-3 : 1.3	Quarterly
Unemployment Rate	9.5 %	Feb/17	9.6	7.3 : 12.1	Monthly
Inflation Rate	1.5 %	Mar/17	2	-0.7 : 5	Monthly
Interest Rate	0 %	Mar/17	0	0 : 4.75	Daily
Balance of Trade	-593 EUR Million	Jan/17	27905	-16510 : 30230	Monthly
Government Debt to GDP	90.7 %	Dec/15	92	64.9 : 92	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	1.06	Apr/17	1.06	0.7 : 1.87	Daily
Stock Market	3496 points	Apr/17	3486	1810 : 4558	Daily
Government Bond 10y	-0.46 %	Apr/17	-0.45	-0.5 : 2.57	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	0.4 %	Dec/16	0.4	-3 : 1.3	Quarterly
GDP Annual Growth Rate	1.7 %	Dec/16	1.8	-5.5 : 5	Quarterly
GDP	11602 USD Billion	Dec/15	13449	245 : 14115	Yearly
GDP Constant Prices	2529 EUR Billion	Dec/16	2519	1769 : 2529	Quarterly
Gross Fixed Capital Formation	508 EUR Billion	Dec/16	505	382 : 572	Quarterly
GDP per capita	38594 USD	Dec/15	37915	10809 : 38822	Yearly
GDP per capita PPP	37737 USD	Dec/15	37068	28120 : 38040	Yearly
Labour	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Unemployment Rate	9.5 %	Feb/17	9.6	7.3 : 12.1	Monthly
Employed Persons	154 Million	Dec/16	153	117 : 154	Quarterly
Unemployed Persons	15318 Thousand	Feb/17	15500	11336 : 19157	Monthly
Long Term Unemployment Rate	4.8 %	Sep/16	5	2.7 : 6.3	Quarterly
Youth Unemployment Rate	19.4 %	Feb/17	19.8	14.9 : 24.7	Monthly
Labour Costs	112 Index Points	Dec/16	102	85.1 : 112	Quarterly
Productivity	104 Index Points	Dec/16	103	82.6 : 104	Quarterly
Wages	1681 EUR/Month	Mar/14	1676	1302 : 1681	Quarterly

The European economy generally is heading in the right direction underpinned by low oil prices, low interest rates and reasonably positive sentiment.

Economic growth for the first time in almost 10 years is underway for all EU member states this year and possibly next year too. Although of course it is supported by a significant increase in fiscal debt and the use of other macro-prudential tools by the European Central Bank, nonetheless this is a useful result that the central bank will be pleased with. So too will everyday citizens in the Eurozone who have side stepped what would otherwise have been some serious pain.

Employment is steadily improving even though it remains above the pre-crisis levels. Private consumption/spending remains the engine of economic recovery and is robust because of low oil prices, low interest rates and therefore confident sentiment. Investment growth however in the European economy continues to remain subdued.

In its latest forecast the European Commission expects economic growth (as measured by GDP) in the Eurozone to grow by 1.8% over both 2017 and 2018. The trick of course will be to stay on track.

At the same time, the positive numbers coming out of the Eurozone are clouded by remaining uncertainty in other areas. They still have high levels of public and private debt which won't go away any time soon. Of course it is the debt servicing that is the real issue. Many European citizens do not feel well off and perceive increased inequalities throughout society. This along with new geo-political challenges such as neighbouring instability and migration conflicts are additional issues that make implementing a solid economic recovery more difficult.

The European economy has surprisingly rebounded into economic growth from last year when serious deflation was looking like a real possibility. Low oil prices and low interest rates continue to support household spending which, as mentioned earlier, is one of the keys to Europe's economic recovery remaining on track.

The United Kingdom

United Kingdom | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.7 %	Dec/16	0.5	-2.7 : 5	Quarterly
Unemployment Rate	4.7 %	Jan/17	4.8	3.4 : 12	Monthly
Inflation Rate	2.3 %	Feb/17	1.8	-0.1 : 8.5	Monthly
Interest Rate	0.25 %	Mar/17	0.25	0.25 : 17	Daily
Balance of Trade	-3663 GBP Million	Feb/17	-2975	-6058 : 2946	Monthly
Government Debt to GDP	89.2 %	Dec/15	88.2	31.3 : 89.2	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	1.23	Apr/17	1.25	1.05 : 2.86	Daily
Stock Market	7349 points	Apr/17	7303	428 : 7430	Daily
Government Bond 10Y	1.08 %	Apr/17	1.1	0.52 : 16.09	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	0.7 %	Dec/16	0.5	-2.7 : 5	Quarterly
GDP Annual Growth Rate	1.9 %	Dec/16	2	-6.1 : 9.8	Quarterly
GDP	2858 USD Billion	Dec/15	2999	72.33 : 3063	Yearly
GDP Constant Prices	470527 GBP Million	Dec/16	467437	107263 : 470527	Quarterly
Gross National Product	492534 GBP Million	Dec/16	482206	4748 : 492534	Quarterly
Gross Fixed Capital Formation	78054 GBP Million	Dec/16	77941	13405 : 80420	Quarterly
GDP per capita	41188 USD	Dec/15	40620	13869 : 41188	Yearly

Despite Brexit, Britain's economy continues to grow although uncertainties remain.

Britain's economy continues to grow with an expansion of 1.9% year on year in the fourth quarter of 2016. Clearly, some large corporates are questioning whether or not they continue to commit staffing levels to Britain and indeed whether or not they maintain their head offices in London. After all, London is a massive financial centre globally and an important driver of economic activity in Britain. Although at this stage it is difficult to assess let alone measure, it would seem that a reduction in staffing levels or repositioning of roles away from London to elsewhere in Europe would have some impact on a local level in London. It is just a question of, to what extent this may play out?

Brexit continues to unfold as Britain heads steadfastly down that path. The number one business concern could be the failure to agree a trade deal on preferential terms with Europe. Indeed, many companies see the two-year time frame limit as difficult or impossible. On the other hand, Britain has the opportunity to go out to the world and look for other trading partners which it has already started by sending a team to India immediately after the Brexit vote was declared. Some sectors though are more vulnerable than others as Brexit unfolds. Britain's car industry looks to be connected to a Europe wide supply chain where components travel to and from Europe several times to be delivered for "just in time" assembly. Obviously tariffs and border holdups could be a serious problem for the UK car industry's "just in time" process. Let's wait and see how that plays out … After all it is in no one's best interest not to look for some sort of solution that fits with the Brexit mandate and minimises damage.

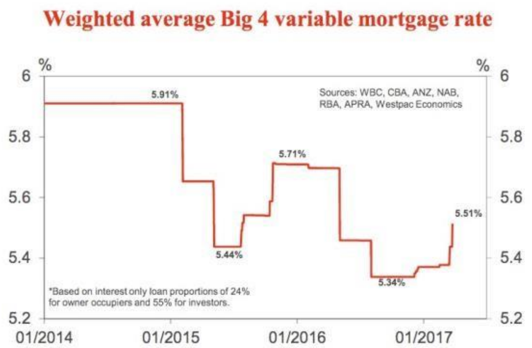
Australia

Australia | Economic Indicators

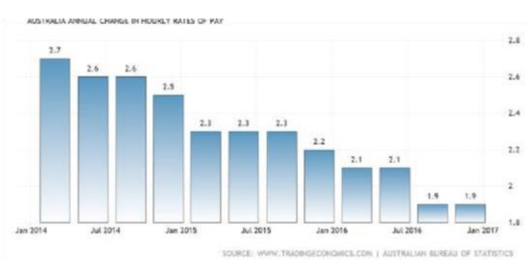
Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	1.1 %	Dec/16	-0.5	-2.1 : 4.4	Quarterly
Unemployment Rate	5.9 %	Feb/17	5.7	4 : 11.1	Monthly
Inflation Rate	1.5 %	Dec/16	1.3	-1.3 : 23.9	Quarterly
Interest Rate	1.5 %	Apr/17	1.5	1.5 : 17.5	Daily
Balance of Trade	3574 AUD Million	Feb/17	1503	-4371 : 3701	Monthly
Government Debt to GDP	36.8 %	Dec/15	34.1	9.7 : 36.8	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	0.75	Apr/17	0.75	0.48 : 1.1	Daily
Stock Market	5862 points	Apr/17	5856	1358 : 6829	Daily
Government Bond 10Y	2.55 %	Apr/17	2.58	1.83 : 16.5	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	1.1 %	Dec/16	-0.5	-2.1 : 4.4	Quarterly
GDP Annual Growth Rate	2.4 %	Dec/16	1.9	-3.4 : 9	Quarterly
GDP	1340 USD Billion	Dec/15	1455	18.6 : 1564	Yearly
GDP Constant Prices	422505 AUD Million	Dec/16	417974	60438 : 422505	Quarterly
Gross National Product	417164 AUD Million	Dec/16	406142	55132 : 417164	Quarterly
Gross Fixed Capital Formation	103943 AUD Million	Dec/16	101298	9479 : 114435	Quarterly
GDP per capita	54708 USD	Dec/15	54233	19172 : 54708	Yearly
GDP per capita PPP	43647 USD	Dec/15	43268	27875 : 43647	Yearly
GDP From Agriculture	10975 AUD Million	Dec/16	10136	3301 : 10975	Quarterly
GDP From Construction	31849 AUD Million	Dec/16	32242	7962 : 33825	Quarterly
GDP From Manufacturing	24296 AUD Million	Dec/16	24600	15598 : 29211	Quarterly
GDP From Mining	29336 AUD Million	Dec/16	28358	4490 : 29608	Quarterly
GDP From Public Administration	23034 AUD Million	Dec/16	22751	7406 : 23034	Quarterly
GDP From Utilities	10658 AUD Million	Dec/16	10676	3808 : 10761	Quarterly
Labour	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Unemployment Rate	5.9 %	Feb/17	5.7	4 : 11.1	Monthly

Although Australia's economy encountered a growth hiccup in the second half of 2016, growth has since recovered and the economy remains broadly on a growth path.

The Reserve Bank of Australia kept interest rates firmly on hold in a recent announcement, citing caution about labour market conditions and household incomes.



Note bank interest rates rising in contrast to the RBA firm hold. Bank funding costs likely represent the difference in direction.

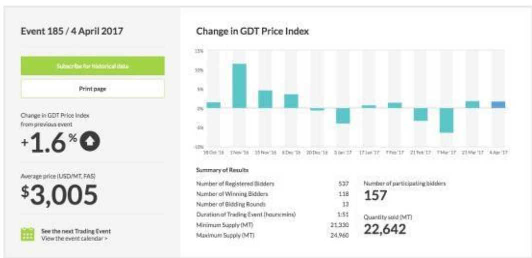


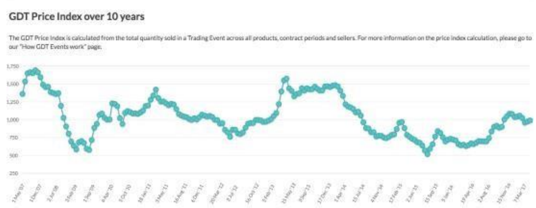
As the chart above shows, wages' growth has been in decline for a number of years and is not good for household confidence and therefore the Australian economy.

Wages' growth is important for the Australian economy because Australia's economy like many developed economies relies on household spending for economic growth. Slowing wages' growth therefore is a head wind for the Australian economy.

Just like in New Zealand, house prices in Australia have been in the media and a potential risk that the Reserve Bank of Australia is keeping an eye on. Although it is always possible, I am not surprised that the housing crash predicted by some in Australia has not materialised. Nonetheless, like New Zealand, Canada and a number of other countries, house prices remain expensive and a drain on the cashflow of many Australians whose debt servicing reduces their capacity to spend and therefore help support economic growth in the broader Australian economy. In general terms though, the Australian economy remains generally on a growth path that looks sustainable for now.

New Zealand





The current trading price hovers around breakeven point for many New Zealand farmers.

New Zealand retains AAA rating. Moodys recently reaffirmed New Zealand's AAA rating based on a stable economic outlook, economic resilience and effective policy making along with strong fiscal position (particularly when compared to many other countries around the world). Moodys also noted New Zealand's number one ranking for ease of doing business which helps support economic growth. Moodys also noted the government's strong focus on preserving robust public finances that provides a buffer for the New Zealand economy in the event of a future economic shock or natural disaster.

Moodys did also warn that New Zealand remains vulnerable to high levels of household debt as well as its reliance on external financing (basically we do not earn enough to pay our way). Aside from that there are also the inevitable growing pains which appear to be most acute in the likes of Auckland with house prices very high and transportation particularly around Auckland becoming a bit more intense (although is it much different than many other large cities around the world?).

To Summarise …

Donald Trump sending 56 cruise missiles to Syria did unsettle the markets momentarily. Since then markets appear to have moved on but remain weary. Putin's response I suspect is yet to be played out. The real question here I believe is whether or not Trump and his team have the skill to navigate us all through a potentially dangerous situation should the current posturing escalate further.

North Korea or more specifically Donald Trump and his team's ability to manage what could be a very tricky situation is a real risk to global stability and short term economic growth. The worst case scenario is difficult to think about, difficult to assess. Stepping back from that situation though, most events, even the difficult ones, have proved manageable in the past and will likely prove manageable in the future too. In the end, for those who cannot help but worry about the worst case scenario, I would ask the question *"Where would your money be safe in that worst case scenario anyway?".* For the sake of clarity, I doubt that safe haven would be your favourite bank. As we have seen during severe difficult economic times, good businesses listed on the so-called sharemarket and governed by transparent listing rules, providing the business itself is of suitable quality, can be a good place to keep our money safe ***and*** *allow it to grow longer term.*

What impact do you think a change in government in September here in New Zealand might have on residential property prices? The point here is that the Labour Party and Winston Peters have talked from time to time about curtailing immigration. What impact do you think that might have? Well if low interest rates are rising and at the same time we have slower demand for those properties, it would not be surprising to see the prices that currently sit at lofty levels retreating back somewhere towards more normal levels. To be clear, whilst the market sets the price and mispricing can continue for many many years to the point where it seems normal, actually, that mismatch can be corrected from time to time as events unexpectedly emerge and impact <u>on the drivers</u> of excessive pricing. No, I am not predicting anything, just saying that high prices that have existed for many years outside of fundamental norms are inevitably unsustainable. Either economic growth needs to improve or prices not grow for a lengthy period of time, or retreat. For example, if property prices in Auckland grew by say 10% and economic growth is only 3% then, we have that fundamental mismatch with prices rising faster than underlying economic growth. Sure, the demand is pushing the prices up, however how "real" (no pun intended) is that? How sustainable are those prices on that basis? I am not suggesting we lose any sleep over it. Just be aware … and remember the election is not far away and anything is possible.

So, the global economy whilst fragile remains on track for steady economic growth. New Zealand's economy has received a pretty strong tick from two ratings' agencies recently, highlighting New Zealand's reasonably sound financial position.

All things equal, it looks as though we can crack on, focus on our big picture goals and take advantage of any pricing volatility that comes along, confident in the knowledge that the New Zealand economy and the global economy are both heading in the right direction for now.

Note South Korea with just about the highest life expectancy in the world.

"One of the greatest ways to avoid trouble is to keep it simple. When you make it vastly complicated – and only a few high priests in each department can pretend to understand it – what you are going to find all too often is that those high priests don't really understand it at all … The system goes out of control."