Economic Update February 2017

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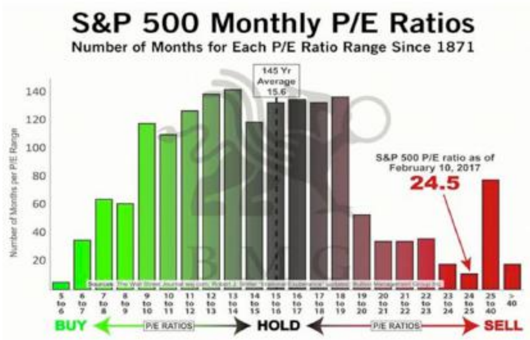
"If you have one economist on your team it's likely that you have one more than you'll need."

Warren Buffett

The Global Economy



The above chart shows that the S&P 500 (a sharemarket index in the US) is expensive, partly the result of what I call "Donald Trump euphoria" as well as other data that has emerged over the last few months.

In November 2016, for the first time in many years, I highlighted the question around whether or not inflation might be something to consider moving forward? As it turns out that anecdotal evidence has continued and whilst we are a very long way from uncontrolled inflation creating havoc around the global economy, inflation data continues to emerge. Even Europe is showing some signs of inflation although their economy is far from out of the woods from the dangers of deflation.

The new US president Donald Trump got straight down to business and pressed forward with many of the themes and ideas that he promoted whilst running for president. In the first 10 days alone, numerous executive orders flowed out of the president's office targeting travel bans for certain citizens of seven predominantly Moslem countries, the importing of goods into the US, that Mexican wall, Obama Care, the TPPA, among others.

Surprisingly, against a lengthy backdrop of deflation, low interest rates and significant economic uncertainty (I am not suggesting that it has gone away necessarily), there is the possibility for the first time in a long while for developed countries to show synchronised growth and that includes growth from the Eurozone as mentioned earlier.

China surprised the markets by appreciating the Chinese renminbi as it attempted to limit capital outflows. Although others might disagree, there is a growing problem for China if it does not stem the outflow of renminbi reserves however at this stage it looks unlikely that it will result in economic crisis for China (and therefore the global economy). To be clear, China is looking like it could encounter a foreign reserves' crises with those reserves dropping to the lowest level since 2011. I am watching…

The Australian economy although mixed, remains reasonably stable with some comments emerging suggesting that the head winds from the unwinding of one of the biggest mining investment booms in Australian history should soon slow down. The Reserve Bank of Australia (RBA) in its assessment suggests that Australia is already around 90% of the way through the fall from the peak of the boom to the expected trough in mining investment. It now looks like a question of how long the trough might last for? Meanwhile, Australia being the financial hub of the South Pacific and a major agricultural exporter continues to muddle along. Like New Zealand, Australia is bracing itself for an increase in interest rates as the year unfolds.

New Zealand is faring reasonably well when compared to many other major economies. Interestingly the election in September this year has the potential to represent a game changer for the New Zealand economy – time will tell.

Latest growth projections
Global economic activity is set to pick up in 2017-18
(Percent change)

	Estimate	Projections	
	2016	2017	2018
World Output	**3.1**	**3.4**	**3.6**
Advanced Economies	**1.6**	**1.9**	**2.0**
United States	1.6	2.3	2.5
Euro Area	1.7	1.6	1.6
Germany	1.7	1.5	1.5
France	1.3	1.3	1.6
Italy	0.9	0.7	0.8
Spain	3.2	2.3	2.1
Japan	0.9	0.8	0.5
United Kingdom	2.0	1.5	1.4
Canada	1.3	1.9	2.0
Other Advanced Economies	1.9	2.2	2.4
Emerging Market and Developing Economies	**4.1**	**4.5**	**4.8**
Commonwealth of Independent States	−0.1	1.5	1.8
Russia	−0.6	1.1	1.2
Excluding Russia	1.1	2.5	3.3
Emerging and Developing Asia	6.3	6.4	6.3
China	6.7	6.5	6.0
India	6.6	7.2	7.7
ASEAN-5	4.8	4.9	5.2
Emerging and Developing Europe	2.9	3.1	3.2
Latin America and the Caribbean	−0.7	1.2	2.1
Brazil	−3.5	0.2	1.5
Mexico	2.2	1.7	2.0
Middle East, North Africa, Afghanistan, and Pakistan	3.8	3.1	3.5
Saudi Arabia	1.4	0.4	2.3
Sub-Saharan Africa	1.6	2.8	3.7
Nigeria	−1.5	0.8	2.3
South Africa	0.3	0.8	1.6
Low-Income Developing Countries	3.7	4.7	5.4

Source: IMF, January 2017 *World Economic Outlook* update.

The above chart shows for the first time in many years the potential outlook for synchronised growth over the next year or two. This is possible unless of course an economic shock erupts unexpectedly which is not out of the question.

Economics versus Investing

Economics is one aspect. Investing is another. That is because as investors we are investing, hopefully, in productive assets that use capital well because of their sustainable competitive advantage. Economic conditions are a complex web of many variables that result in nothing more than a random walk for markets. In other words, market conditions may respond to certain interference or engineering and those conditions will also respond usually in a sharp unexpected fashion to events or data that suddenly emerges that it just does not like. Particularly in the short term, economic conditions tend to determine the price of the assets we invest in which is why an over-emphasis on economic conditions for long term investors is an unwise practice and to be avoided.

The first chart above (at the top) highlights my ongoing lament that prices remain somewhat expensive although not in so-called "bubble" territory like we have seen in the past. That said, it can be difficult working out exactly to what extent cashflows of businesses are the result of central bank monetary stimulation. No matter, good businesses are those that can be said to have a sustainable competitive advantage and whilst their trading price will rise and fall along with market sentiment, longer term the economics (the second chart - on the left) become less important.

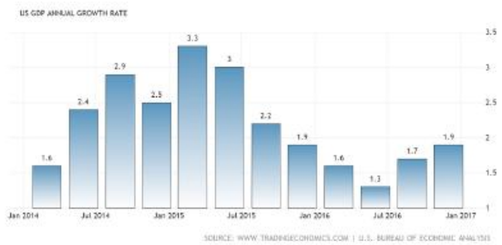
Although the second chart is only an estimate (not a guarantee) synchronised growth among many so-called developed economies looks quite possible over the next year or two. It is not perfect. It is positive and we will go with that for now …

The United States of America

United States | Economic Indicators

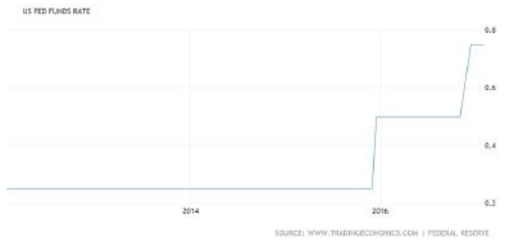
Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	1.9 %	Dec/16	3.5	-10 : 16.9	Quarterly
Unemployment Rate	4.8 %	Jan/17	4.7	2.5 : 10.8	Monthly
Inflation Rate	2.5 %	Jan/17	2.1	-15.8 : 23.7	Monthly
Interest Rate	0.75 %	Feb/17	0.75	0.25 : 20	Daily
Balance of Trade	-44262 USD Million	Dec/16	-45730	-67823 : 1946	Monthly
Government Debt to GDP	104 %	Dec/15	103	31.7 : 122	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	101	Feb/17	101	71.32 : 165	Daily
Stock Market	20624 points	Feb/17	20620	41.2 : 20624	Daily
Government Bond 10Y	2.44 %	Feb/17	2.41	1.36 : 15.82	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	1.9 %	Dec/16	3.5	-10 : 16.9	Quarterly
GDP Annual Growth Rate	1.9 %	Dec/16	1.7	-4.1 : 13.4	Quarterly

With unemployment below 5% and economic growth steady, the American economy along with assistance from Donald Trump might be looking forward to ongoing growth. Notice the "government debt to GDP" sitting at 104%. Over 100% is not a good look.

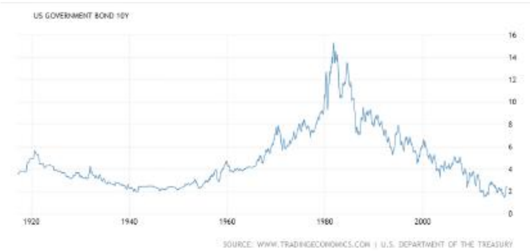


Economic growth has been reasonable although variable. It looks as though the annual growth rate of economic expansion in the US is improving again from the low of 1.3% in July last year.

Making America great again is what Donald Trump says he is all about. In overly simplistic terms that means making American grow and giving the people back the power. The US economy has been stable for some time and with Trump looking as though he will attempt to drive his policies home, there is the real possibility that the US economy may see further growth ahead. It does not mean that there are not risks and that all is well. For example, debt continues to grow and of course the servicing of that debt is a real drag on the economy and economic growth, plain and simple. So too is tax cuts although we will need to wait and see how those are implemented. It is fair to say that deflationary pressures that once dogged the American economy are now firmly to one side but I would not say they have been eliminated.



Two interest rate hikes underway already, three more projected for 2017. Can the US Fed pull it off?

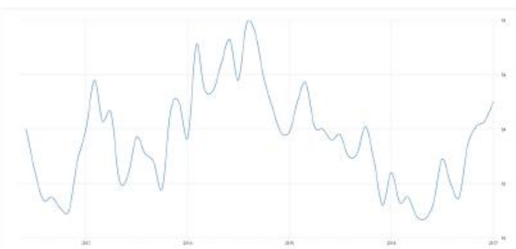


The above chart provides a better perspective of what is really going on, not only with interest rates but also the US economy and the global economy.

If history is anything to go by (see the chart immediately above) those large interest rate cycles can take decades to move through.

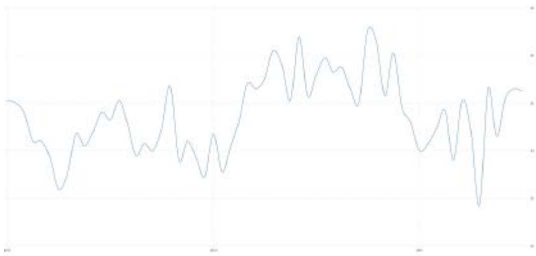
Lower interest rates generally means rising asset prices … Does this mean then that share prices are heading towards a major crash with interest rates heading upwards? In the short term rising interest rates can cause asset prices to decline. Asset prices are indeed a function of interest rates, particularly in the short term. The good news is that longer term the fundamentals of those productive assets in which we invest will determine how much money we make – not interest rates or the economy. That by the way is what separates WISEplanning from most other investment methodologies available. However, expect the market in the short term to be on the alert and to react strongly if it suddenly decides it does not like rising interest rates. For us, that will likely mean better buying opportunity as prices decline in response to the market's negative reaction to rising interest rates.

Interest rates therefore look likely to rise over the next 12 months at least, all things equal.



The previous chart (bottom of the left hand column) measures the manufacturing index in America. Note the upward trend over the last couple of years.

The Markit US Manufacturing PMI reached 55 in January this year which was above 54.3 in December 2016. Any number above 50 represents growth and is a good thing. This reading at 55 indeed is the highest reading since March 2015. This is because we are seeing some solid output and renewed manufacturing growth.



The above chart measures non-manufacturing production and as you can see is loosely following the upward trend of the manufacturing sector. That is a good thing.

However at the same time our old "friend" ***household debt*** that looked as though it was under control and heading in the right direction (downward) has since rebounded and is reaching levels not seen since the Global Financial Crisis peak around 2008. At that time consumer debt amounted to a record high of US$12.68 trillion. Americans felt wealthy and were borrowing more and more money – and spending it. With household debt having climbed to US$12.58 trillion at the end of 2016, by some estimates a new record will be set some time over 2017 which is less than ideal. That is because it is not the debt but rather the debt servicing that becomes the problem when things become difficult in the future. Those who have borrowed excessively are unable to make the payments and in a worst case scenario a credit crunch can unfold. That's right, that's what we saw in 2008 on the back of the US housing crisis, the catalyst for the so-called *Global Financial Crisis.*

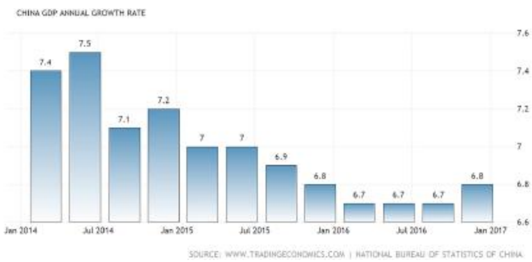
So what we have now in the US economy is a mixed bag with debt likely to increase and therefore the debt servicing which ultimately creates a head wind for the US economy that will need real growth (4% + economic expansion each year for the foreseeable future in my view) which has not been achieved for a very long time. The immediate future looks stable and somewhat positive even if the long term outcome remains less certain.

China

China | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	1.7 %	Dec/16	1.8	1.3 : 2.4	Quarterly
Unemployment Rate	4.02 %	Dec/16	4.04	3.9 : 4.3	Quarterly
Inflation Rate	2.5 %	Jan/17	2.1	-2.2 : 28.4	Monthly
Interest Rate	4.35 %	Jan/17	4.35	4.35 : 10.98	Daily
Balance of Trade	514 USD HML	Jan/17	407	-320 : 628	Monthly
Government Debt to GDP	43.9 %	Dec/16	41.1	20.5 : 43.9	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	6.87	Feb/17	6.86	1.53 : 8.73	Daily
Stock Market	3253 points	Feb/17	3240	99.98 : 6092	Daily
Government Bond 10Y	3.35 %	Feb/17	3.37	2.51 : 4.85	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	1.7 %	Dec/16	1.8	1.3 : 2.4	Quarterly
GDP Annual Growth Rate	6.8 %	Dec/16	6.7	3.8 : 15.4	Quarterly
GDP	11008 USD Billion	Dec/15	10482	47.21 : 11008	Yearly
Gross National Product	673837 CNY HML	Dec/15	634367	679 : 673837	Yearly
Gross Fixed Capital Formation	292396 CNY HML	Dec/15	283018	80.7 : 292396	Yearly
GDP per capita	6498 USD	Dec/15	6108	132 : 6498	Yearly
GDP per capita PPP	13572 USD	Dec/15	12759	1526 : 13572	Yearly
GDP Constant Prices	744127 CNY HML	Dec/16	529971	5263 : 744127	Quarterly
GDP From Agriculture	63671 CNY HML	Dec/16	40666	649 : 63671	Quarterly
GDP From Construction	49522 CNY HML	Dec/16	33193	182 : 49522	Quarterly
GDP From Manufacturing	187836 CNY HML	Dec/16	177101	2208 : 228974	Quarterly
GDP From Services	384221 CNY HML	Dec/16	279890	2213 : 384221	Quarterly
GDP From Transport	33355 CNY HML	Dec/16	24160	393 : 33355	Quarterly
Labour	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Unemployment Rate	4.02 %	Dec/16	4.04	3.9 : 4.3	Quarterly

Economic expansion is still showing as 6.7%.

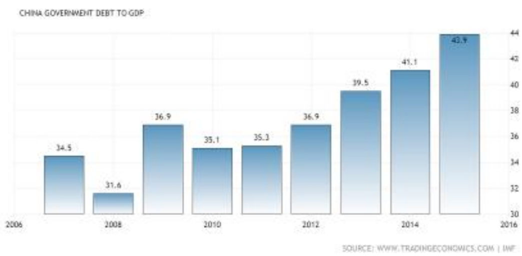


The trend for Chinese economic growth is definitely down although the most recent report shows an upward blip in the downward trend.

The Chinese economy grew by 6.8% year on year in the fourth quarter of 2016 compared to 6.7% growth in the previous three periods. This was the strongest expansion since the fourth quarter of 2015 and appears to be supported by consumer spending, higher government expenditure and, with the encouragement of the Chinese government, an increase in bank lending.

China will be facing more head winds from Donald Trump in the US as trade talks are bound to come up at some point over 2017. In the meantime, government driven bank lending is providing a stimulus to support economic growth in the short term in China.

Debt generally is becoming an increasing problem for the Chinese economy. This chart shows the steady increase in household debt when compared to economic growth as measured by GDP.



Government debt compared to economic growth (as measured by GDP) also continues to rise – not ideal.

Economic growth in China remains reasonably steady although it is a managed growth supported by Chinese government intervention. Debt continues to grow fast and although less than ideal, debt levels are still reasonably tame when compared to other economies. For example, government debt sitting at less than 50% of economic growth (GDP) is more favourable than government debt at over 100% of GDP in the US.

Over-capacity in the Chinese economy is likely to become an increasing problem as inefficiencies leading to work closures result in displaced workers. It appears though that by some estimates, displaced workers might eventually be absorbed into new sectors in the economy.

Unemployment remains below 4% in China which if correct does support economic expansion in the future.

Trade between the US and China is likely to be a key factor for both economies should Donald Trump initiate a trade war with China. Going back in time, China needed America's western technology and manufacturing techniques. Whilst innovation is a key ingredient that in my opinion America has over China, nonetheless China has most of what it needs in respect of technology and manufacturing techniques at the moment. Anyway what it does not have it can obtain from vendors outside the US. The American market is still important for China in my view however it is considered a relatively mature market and China may look at newer emerging markets in the event of a trade dust up with the US. America on the other hand might need China more as its large corporations (e.g. Starbucks) look to expand their businesses. China represents a huge market and significant growth for these large US corporations looking to expand.

The Chinese economy continues to expand; remains stable due to intensive government hands on management and may not come off second best in a trade war with the US.

The Eurozone

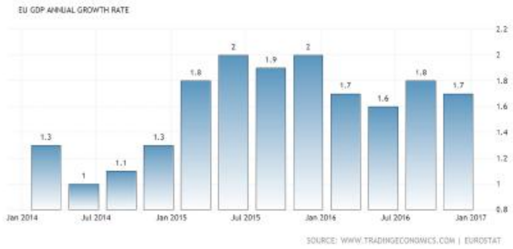
Euro area | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.4 %	Dec/16	0.4	-3 : 1.3	Quarterly
Unemployment Rate	9.6 %	Dec/16	9.7	7.2 : 12.1	Monthly
Inflation Rate	1.8 %	Jan/17	1.1	-0.7 : 5	Monthly
Interest Rate	0 %	Jan/17	0	0 : 4.75	Daily
Balance of Trade	28142 EUR Million	Dec/16	25365	-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	Feb/17	1.06	0.7 : 1.87	Daily
Stock Market	3302 points	Feb/17	3312	1810 : 4558	Daily
Government Bond 10y	-0.45 %	Feb/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	2530 EUR Billion	Dec/16	2516	1769 : 2530	Quarterly
Gross Fixed Capital Formation	508 EUR Billion	Sep/16	507	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	9.6 %	Dec/16	9.7	7.2 : 12.1	Monthly
Employed Persons	153 Million	Sep/16	153	117 : 153	Quarterly
Unemployed Persons	15452 Thousand	Dec/16	15781	11336 : 19157	Monthly

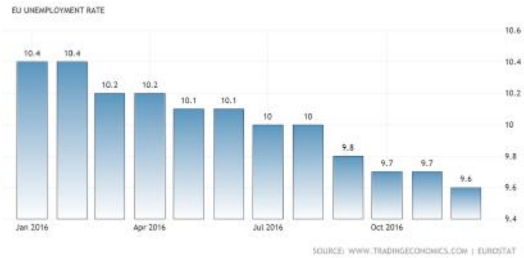
Although interest rates remain flat lined on 0% (let's face it, this is pretty weird stuff) inflation however appears to be emerging – now that is surprising.

The European economy has been on a stable track for the last several months buoyed by low oil prices, ongoing low interest rates and central bank intervention.

Although Brexit may impact down the track, it remains unclear just what the outcome will be and how that process will actually manifest itself on the European economy. In my opinion, on the one hand whilst there are some obvious negatives in terms of trade, security and possibly economic growth, on the other hand this type of event in the past has forced the respective countries to step back, take a look at themselves, who they trade with and forge new relationships, creating new opportunities. Both the UK and Europe have in theory, advanced economies and *reasonably* stable government. Perhaps all they need is the appetite to be a bit innovative and look for other opportunity – what do you think?

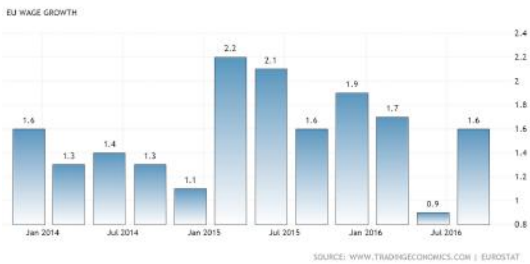


Although strongly supported by central bank intervention as well as low interest rates and low oil prices, economic growth is expanding in Europe.



Unemployment continues to steadily decline – that's good.

With unemployment steadily tracking down this represents reasonably good progress for the European economy however when compared to, for example say the US or New Zealand whose unemployment rates sit at around 5% (approximately), the Euro area has quite a long way to go. Low unemployment is necessary for stable and solid economic expansion.

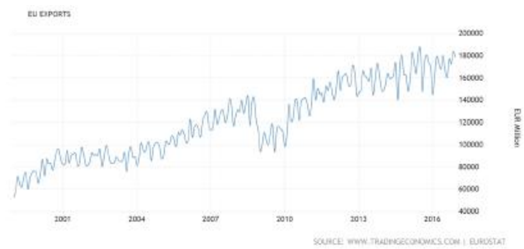


Wages growth looks patchy and appears to have little direction.

Wages growth in the Euro area has been a bit up and down although largely positive over the last couple of years. Wages growth is another important indicator of an economy undergoing solid expansion. Although the above chart is not horrible, it does need to improve.

Household debt in the Euro area continued to grow until just after the Global Financial Crisis 2008. Since then household debt when compared to economic growth has steadily declined.

Household debt in Europe is actually heading in the right direction unlike the US. As mentioned previously, household debt at high levels can create a head wind for economic growth which is why declining household debt for the Euro area is a positive.



Whilst 2008 provided challenge for exporting, the long term trend has been positive over the medium to long term.

Although there is the question of the likes of farming subsidies, Europe has generated increasing exports to the rest of the world reasonably consistently over the long term. Although I am not convinced Brexit will be a game changer, nonetheless it will impact to some extent and to just what extent, it will be interesting to observe.

The UK

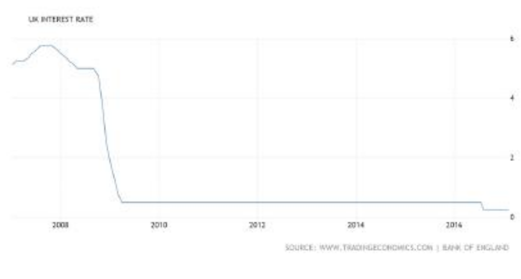
United Kingdom | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.6 %	Dec/16	0.6	-2.7 : 5	Quarterly
Unemployment Rate	4.8 %	Dec/16	4.8	3.4 : 12	Monthly
Inflation Rate	1.8 %	Jan/17	1.6	-0.1 : 8.5	Monthly
Interest Rate	0.25 %	Feb/17	0.25	0.25 : 17	Daily
Balance of Trade	-3304 GBP Million	Dec/16	-3559	-6058 : 2946	Monthly
Government Debt to GDP	89.2 %	Dec/16	88.2	31.3 : 89.2	Yearly
Markets	Last	Reference	Previous	Range	Frequency
Currency	1.24	Feb/17	1.25	1.05 : 2.86	Daily
Stock Market	7270 points	Feb/17	7300	428 : 7338	Daily
Government Bond 10Y	1.24 %	Feb/17	1.23	0.52 : 16.09	Daily
GDP	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.6 %	Dec/16	0.6	-2.7 : 5	Quarterly
GDP Annual Growth Rate	2.2 %	Dec/16	2.2	-6.1 : 9.8	Quarterly
GDP	2858 USD Billion	Dec/15	2999	72.33 : 3063	Yearly
GDP Constant Prices	471584 GBP Million	Dec/16	468771	107263 : 471584	Quarterly
Gross National Product	482897 GBP Million	Sep/16	475301	4748 : 482897	Quarterly
Gross Fixed Capital Formation	78402 GBP Million	Sep/16	77718	13405 : 80420	Quarterly
GDP per capita	41188 USD	Dec/15	40620	13869 : 41188	Yearly
GDP per capita PPP	38866 USD	Dec/15	38330	26629 : 38866	Yearly
GDP From Agriculture	3166 GBP Million	Dec/16	3154	2350 : 3267	Quarterly
GDP From Construction	26040 GBP Million	Dec/16	26025	20035 : 26245	Quarterly
GDP From Manufacturing	41195 GBP Million	Dec/16	40921	37451 : 43548	Quarterly
GDP From Mining	7441 GBP Million	Dec/16	7991	6493 : 16722	Quarterly
GDP From Public Administration	18929 GBP Million	Dec/16	18945	18888 : 22274	Quarterly
GDP From Services	337081 GBP Million	Dec/16	334410	171542 : 337081	Quarterly
GDP From Transport	17964 GBP Million	Dec/16	17784	9402 : 18739	Quarterly

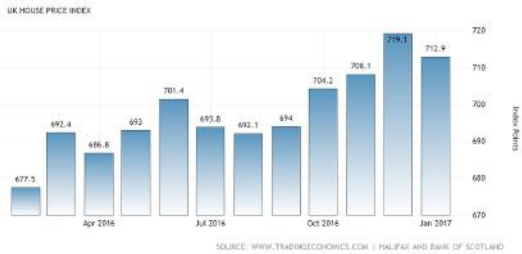
Interest rates remain low and economic growth moderate but regardless of Brexit the UK economy remains reasonably stable for now.

Brexit has really had little impact economically although there has been a good deal of uncertainty which has not helped things. However at the moment we have yet to see any real impact to Britain's economy as a result of the Brexit vote. Like Europe, Britain now has the opportunity to be innovative and consider what new trading relationships it can develop.

British manufacturers had their best month in two years in February however the decline in the pound is making them push up their prices which could pose a challenge for 2017. The reality is that so far the Brexit vote has failed to hurt Britain's economy. This is in stark contrast to many commentators whose negative disposition saw them predicting a sharp hit to economic output for the UK – yet to materialise. Interestingly, the manufacturing sector in Britain accounts for around 10% of the country's economy, which is much smaller than Britain's services sector.



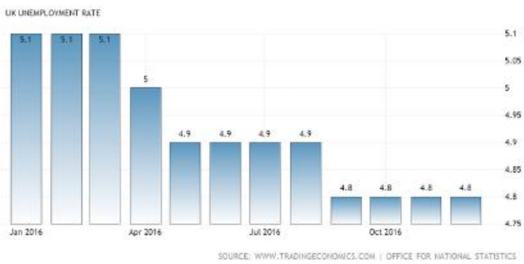
Interest rates remain at a record all time low at 0.25% - necessary but weird.



House prices remain stretched in the UK – a bit like New Zealand.

Low interest rates are helping house prices to rise along with ongoing strong demand. So long as those two factors remain in place house prices will likely remain stretched and possibly continue to climb even higher.

Although the Central Bank of England has a variety of macro prudential tools at its disposal, interest rate levels have been a key tool that the Chancellor the Exchequer in Britain and other central bankers around the world have used to help stabilise their respective economies. The problem for Britain's economy is that, with interest rates sitting at record lows (currently 0.25%) this leaves little wriggle room should economic conditions become difficult (e.g. Brexit impact down the track).



Unemployment remains at a healthy 4.8%.

As the chart above shows, unemployment has remained reasonably consistent and running at under 5% suggests a stable economic base for economic growth in the future.

Japan

Japan | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.2 %	Dec/16	0.3	-4.8 : 3.2	Quarterly
Unemployment Rate	3.1 %	Dec/16	3.1	1 : 5.6	Monthly
Inflation Rate	0.3 %	Dec/16	0.5	-2.52 : 25	Monthly
Interest Rate	-0.1 %	Jan/17	-0.1	-0.1 : 9	Daily
Balance of Trade	-1087 JPY Billion	Jan/17	641	-2795 : 1609	Monthly
Government Debt to GDP	229 %	Dec/16	226	50.6 : 229	Yearly
Markets	Last	Reference	Previous	Range	Frequency
Currency	114	Feb/17	113	75.74 : 307	Daily
Stock Market	19381 points	Feb/17	19251	85.25 : 38916	Daily
Government Bond 10Y	0.1 %	Feb/17	0.1	-0.29 : 7.59	Daily
GDP	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	0.2 %	Dec/16	0.3	-4.8 : 3.2	Quarterly
GDP Annual Growth Rate	1.7 %	Dec/16	1.1	-8.8 : 9.4	Quarterly
GDP Growth Annualized	1 %	Dec/16	1.4	-18 : 12.9	Quarterly
GDP	4123 USD Billion	Dec/15	4596	44.31 : 5957	Yearly
GDP Constant Prices	524291 JPY Billion	Dec/16	523050	263584 : 524291	Quarterly
Gross National Product	549544 JPY Billion	Dec/16	549483	263298 : 549544	Quarterly
Gross Fixed Capital Formation	122051 JPY Billion	Dec/16	122064	71463 : 141747	Quarterly
GDP per capita	44657 USD	Dec/15	44386	8369 : 44657	Yearly
GDP per capita PPP	35804 USD	Dec/15	35587	29550 : 35804	Yearly
GDP From Agriculture	4700 JPY Billion	Dec/15	6277	4700 : 7550	Yearly
GDP From Construction	28189 JPY Billion	Dec/15	28205	25584 : 42167	Yearly
GDP From Manufacturing	103814 JPY Billion	Dec/15	111232	81252 : 111580	Yearly
GDP From Mining	233 JPY Billion	Dec/15	194	180 : 515	Yearly
GDP From Public Administration	30780 JPY Billion	Dec/14	30811	25528 : 31043	Yearly
GDP From Services	22201 JPY Billion	Dec/15	95137	22201 : 96295	Yearly
GDP From Transport	24767 JPY Billion	Dec/15	24319	22408 : 27094	Yearly
GDP From Utilities	8424 JPY Billion	Dec/15	7612	7532 : 12212	Yearly

Economic expansion in Japan has emerged although at a low level.

The end of 2016 for Japan saw data around global trade emerge that helped improve exports out of Japan which in December recorded their first positive reading in around 15 months. However, the withdrawal from the Trans Pacific Partnership (TPP) is a blow to future economic exports to the US and potentially their relationship. Donald Trump in a recent meeting with prime minister Shinzo Abe saw Donald Trump comment outright that the current trade deficit with Japan is "just not fair". Although we will need to wait and see, this raises the possibility that America could consider imposing trade barriers to Japanese trade with the US.

Japan GDP Chart

Note: Quarter-on-quarter seasonally adjusted annualized changes and annual variation of GDP in %.
Source: Cabinet Office (CO) and FocusEconomics Consensus Forecast.

The Japanese economy managed to expand for the fourth consecutive quarter in the fourth quarter of 2016, however growth softened in the October to December period as a result of stagnating private demand. Wage growth continues to remain sluggish which limits any upswing in household spending. This continues to challenge the idea that the Japanese economy can emerge from over two decades of solid deflation.

Overall, it appears that the Japanese economy continues to rely on the external sector to keep economic growth afloat in Japan. Donald Trump's protectionist policies therefore won't be helpful in the future. The US is Japan's biggest export market after China which makes this situation potentially tricky for ongoing expansion in the Japanese economy. Anyway, the Bank of Japan is projecting economic expansion in Japan of between 1.3% and 1.6% in the fiscal year 2017 which ends in March 2018. Time will tell …

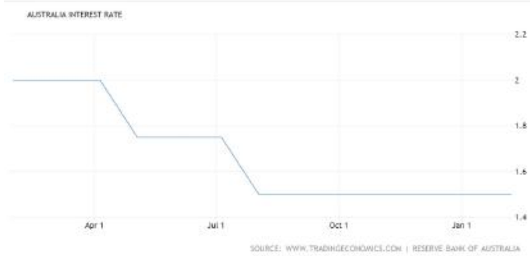
Australia

Australia | Economic Indicators

Overview	Last	Reference	Previous	Range	Frequency
GDP Growth Rate	-0.5 %	Sep/16	0.6	-2.1 : 4.4	Quarterly
Unemployment Rate	5.7 %	Jan/17	5.8	4 : 11.1	Monthly
Inflation Rate	1.5 %	Dec/16	1.3	-1.3 : 23.9	Quarterly
Interest Rate	1.5 %	Feb/17	1.5	1.5 : 17.5	Daily
Balance of Trade	3511 AUD Million	Dec/16	2040	-4392 : 3511	Monthly
Government Debt to GDP	36.8 %	Dec/15	34.1	9.7 : 36.8	Yearly
Markets	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
Currency	0.77	Feb/17	0.77	0.48 : 1.1	Daily
Stock Market	5791 points	Feb/17	5783	1358 : 6829	Daily
Government Bond 10Y	2.8 %	Feb/17	2.81	1.83 : 16.5	Daily
GDP	**Last**	**Reference**	**Previous**	**Range**	**Frequency**
GDP Growth Rate	-0.5 %	Sep/16	0.6	-2.1 : 4.4	Quarterly
GDP Annual Growth Rate	1.8 %	Sep/16	3.1	-3.4 : 9	Quarterly
GDP	1340 USD Billion	Dec/15	1455	18.6 : 1564	Yearly
GDP Constant Prices	417688 AUD Million	Sep/16	419674	60438 : 419674	Quarterly
Gross National Product	406142 AUD Million	Sep/16	402695	55132 : 406142	Quarterly
Gross Fixed Capital Formation	101340 AUD Million	Sep/16	104168	9479 : 114469	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	9601 AUD Million	Sep/16	8934	3301 : 9980	Quarterly
GDP From Construction	32222 AUD Million	Sep/16	33412	7962 : 33842	Quarterly
GDP From Manufacturing	24657 AUD Million	Sep/16	24687	15598 : 29210	Quarterly
GDP From Mining	28476 AUD Million	Sep/16	28705	5812 : 29606	Quarterly
GDP From Public Administration	22750 AUD Million	Sep/16	22734	7406 : 22757	Quarterly
GDP From Utilities	10629 AUD Million	Sep/16	10697	3808 : 10768	Quarterly

Economic growth continues at around 3% which is not a bad effort overall.

Whilst unemployment is slightly high at 5.8%, economic growth continues to run at slightly over 3% which is not bad.

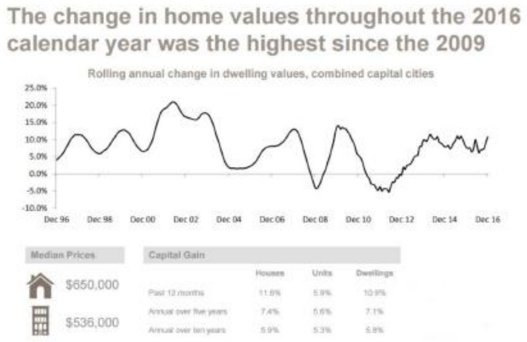


Interest rates remain on hold for now but for how long?

At the meeting held on February 7 2017, the Reserve Bank of Australia left the cash rate unchanged at a record low of 1.5%. Policy makers in Australia expect inflation to remain low for some time. They also see the potential for further increases in resource exports as the phase of declining mining investment diminishes and increased investment is initiated in due course. Indeed, the Reserve Bank of Australia is expecting economic growth to sit at around 3% annualised over the next couple of years or so. Obviously growth in resource exports will help boost further economic expansion. Interest rates at current levels are considered to be accommodative. With the outlook for inflation remaining subdued, interest rate rises are unlikely to be significant and equally unlikely to be swift. However, the cost of borrowing offshore is increasing and also there is the prospect of US interest rates rising over 2017 too.

Housing in Australia is big business and continues to underpin wealth in Australia.

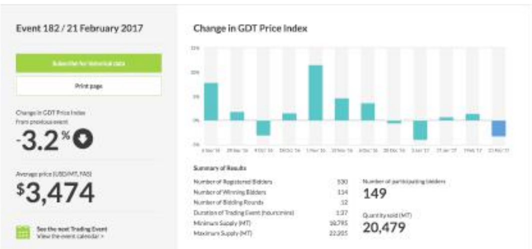
The above chart tells a troubling story because when you compare the $6.8 trillion of real estate investment with the $1.7 trillion worth of listed stocks it is worth remembering that those listed stocks provide substantial employment for Australians. How wealthy would Australians be if the Australian listed stock number on that chart and the residential real estate numbers were reversed? Housing is an essential requirement in terms of shelter, however businesses are productive assets that provide employment and economic growth. Nothing wrong with investing in residential real estate, however for many Australians their own home is their only asset aside from their superannuation scheme and of course it is unlikely that their own home will generate a cashflow.



We see this in many countries around the world including New Zealand; the above chart shows that house prices usually rise more in the larger cities.

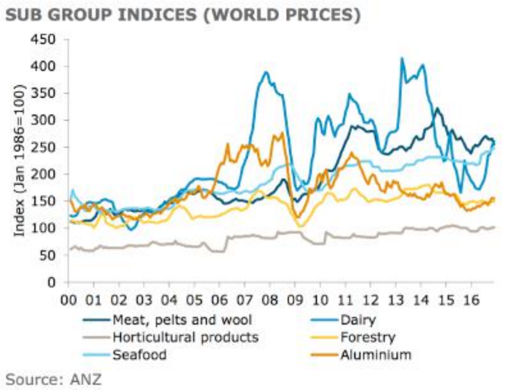
New Zealand

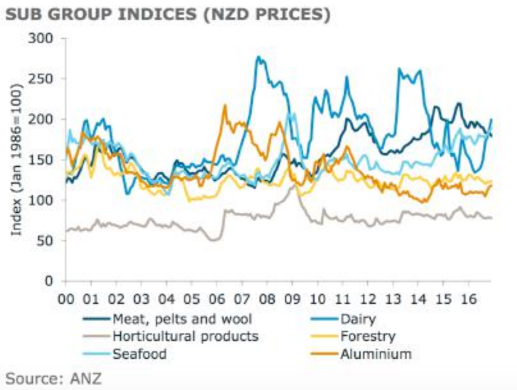
Dairy auction price



Although the most recent dairy auction declined a bit, the recent trend remains in an upward direction.

Dairy prices appear to have stabilised after what for dairy farmers must have seemed like an eternity over 2014 through 2016 as the price continued to decline. Of course, the behaviour of milk solid pricing is like any other commodity, volatile at best.

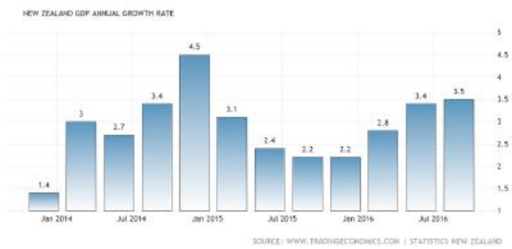




The top chart shows world prices excluding the impact of a rising New Zealand dollar and the bottom chart shows those same prices but taking into account movements in the New Zealand dollar against other currencies.

Towards the end of last year Chinese demand helped drive demand for milk solids along with tight global milk supplies. Interestingly there was a large 6.2% decline in wool prices which has meant a tough year with the year on year wool price down 26%. That is a sizeable decline. It appears the main reason has been the lack of interest from China who account for around 50% of exports. The best guesses as to why Chinese demand has been weaker seem to revolve around a weaker renminbi, the possible liquidation of local cotton stocks (in China), possible changing local fashion trends, the possibility of the sourcing of cheaper product from the UK and perhaps Mongolia. Whatever the reason, a 55% fall over 2016 in Chinese exports is a big number.

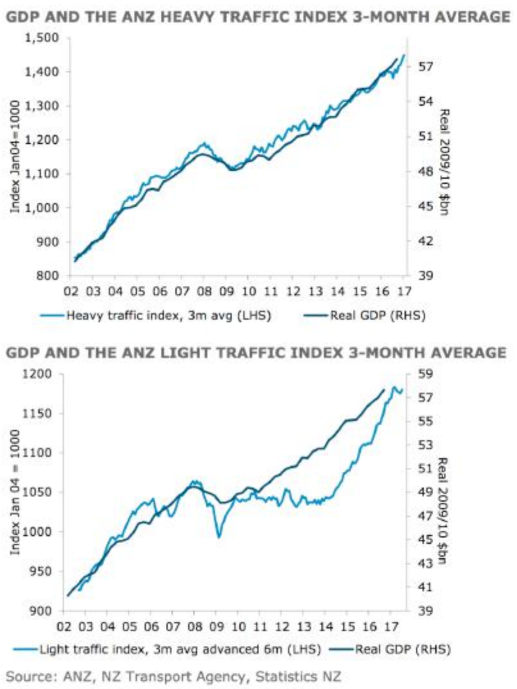
Looking at other commodities, beef prices also fell 5.5% in December; land prices fell 2.4% for the month. Forestry prices posted a small gain in December. Otherwise there were relatively minor moves. Anyway, short term movements in prices do not really tell us much.



Economic expansion in New Zealand whilst not spectacular is nonetheless solid.

Economic growth as measured by GDP has been reasonably solid which is remarkable given global conditions. Although let's not over think it, the global economy appears to be based on the liquidity bubble still with increasing debt in many economies along with low interest rates and ongoing central bank intervention.

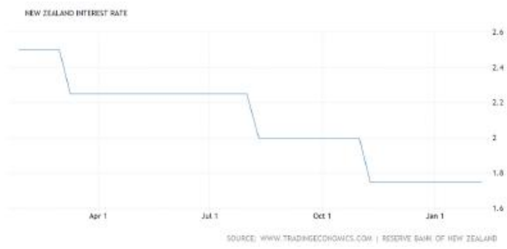
The ANZ truckometer showed a slight decline in January this year. The heavy traffic index fell 0.8% over the month while the light traffic index fell 0.5% over the month.



Notice the correlation between economic growth (real GDP) and the truckometer index.

Looking ahead, it is possible that growth remains steady rather than fast paced as the New Zealand economy starts to run into speed bumps such as increasing levels of debt and possible labour shortages. Global risks can play a large part in the fortunes of small narrow economies such as New Zealand. The restructuring of trade agreements initiated by Brexit and the US are two factors that could have some impact on New Zealand. Steady as we go for now …

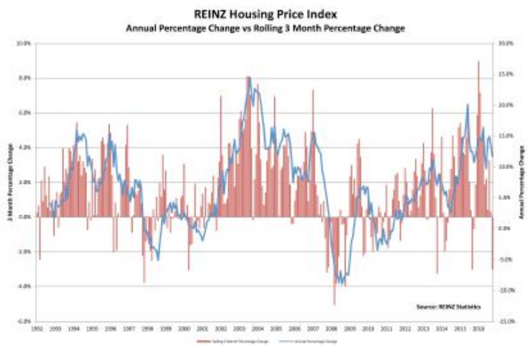
Interest rates



Interest rates remain low, however that may change soon.

On February 8 the Reserve Bank of New Zealand kept its official cash rate unchanged at a record low of 1.75% - not unexpected. However, policy makers believe that financial conditions have firmed with long term interest rates rising and continued upward pressure on the New Zealand dollar. The Reserve Bank's perspective is that the exchange rate for the New Zealand dollar is higher than is sustainable for long term balanced growth. Interestingly, inflation has returned to the target band of 1% to 3% and is expected to continue to strengthen. Other important considerations for the Reserve Bank would have been I imagine rising commodity prices and an increase in long term global interest rates. I expect monetary policy to remain accommodative and for interest rates to gradually rise, starting perhaps toward the mid point of 2017. Obviously, the US Fed and rising interest rates in the US will be something to watch with three rate increases signalled so far for the rest of 2017.

Residential property

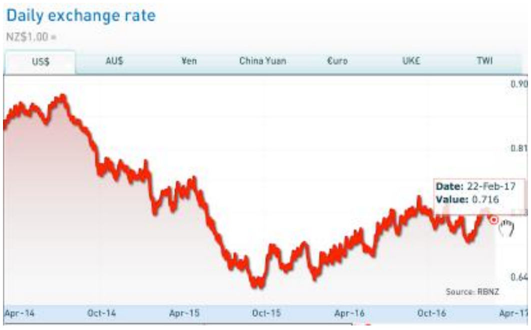


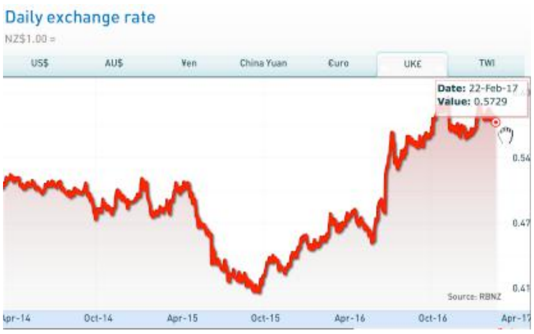
Note the recent fall off in house prices.

House prices in New Zealand are among the most expensive in the world. This does not mean that house prices will necessarily crash any time soon. I know that some commentators are predicting it – whilst I cannot predict the future I do not see how they can either. Anyway, I do not see an all out sell off in the housing market in New Zealand.

That said … the election coming up in New Zealand in September is a potential game changer. Immigration has been a reasonably hot topic over the last couple of years with immigration levels continuing to roll on at record levels. A slow down in immigration would impact without question at some point on house prices. Also we have interest rates rising which I imagine will be a gradual process and a slow burn that gradually reduces the investor participants down to those who have strong cashflows and lots of equity.

Currency





To Summarise …

Donald Trump and Brexit are two well known examples of anti-establishment sentiment. Indeed, it has almost become fashionable to be angry and feel disaffected – at least in certain sectors of the community around the world. Hence the phrase you may have seen some time ago around *"the economists versus the psychologists"*. The point here is that when a group of people en masse decide to move in a particular direction then the establishment who should already be taking notice and be one step ahead had better watch out. There is nothing like change to capture everyone's attention.

However, Brexit looks like a slow burn and the outcome is yet to be determined. As for Donald Trump as president, as unlikely as it would seem, the markets appear to be liking it and there are some positives if he can deliver on such promises as tax cuts for large US corporations and the $1 trillion infrastructure spend among other initiatives.

Since Donald Trump's election as president, the markets have responded positively and are pricing in those initiatives that he campaigned on. At the same time, whilst there appears to be the possibility of synchronised growth around the world, asset prices remain expensive. For example the Dow Jones sharemarket index continues to break new ground as it goes from one record level to the next since Donald Trump's election. Getting into the market is usually a good thing long term although chasing after rising prices is great whilst prices rise but can become somewhat awkward when circumstances reverse, particularly if it is a sudden short term change.

Debt around the world continues to increase in many countries. For example China's debt whilst still manageable continues to grow. Household debt in the US is getting close to the all time record just prior to 2008 – not good. US government debt recently breached the 100% of GDP threshold which is considered to be a line not to cross. That said, the United States of America has a unique economic machine that is unparalleled anywhere else in the world. This does not mean that the American economy won't stumble at some point, however this unique machine has proven to be highly resistant in the past and I believe will continue to be so in the future. The impact of Donald Trump will be noticeable over the next few years but become less meaningful further into the future.

Europe is showing signs of some growth and even Japan has shown some evidence of economic growth although minimal. Inflation appears to be emerging for the first time in many years and interest rates look as though they may rise although I suspect at a slow pace.

Residential property in New Zealand I suspect will remain one of the favoured investments for some time to come although let's keep an eye out for that election in September and let's think early about what a change in government might mean for immigration and therefore house prices.

Sharemarkets are having a reasonably good run but let's not forget that price and value are not the same thing. With the price earnings ratio on the S&P 500 Index running at around 24 or so, prices are without doubt factoring in future income that is yet to be earned. Still, opportunities for companies that are overlooked by the market exist. They are not easy to find but can represent good investment opportunity regardless of economic conditions, particularly in the long run.

So, the economics are mixed but tending to the positive and asset prices generally are expensive. In my experience, rather than chasing after the market we are just as well to deploy our proven methodology, trust it and let it keep us out of harm's way, regardless of changing economic conditions. Let's keep an eye on economic conditions and the markets but let's not play that game. Let's invest in the sound economics of an underlying business. Let's not play the markets. That way we can make money and sleep at night.

> *"Formal education will make you a living;*
> *self-education will make you a fortune."*
>
> Jim Rohn