Economic Snapshot
Aug 2019

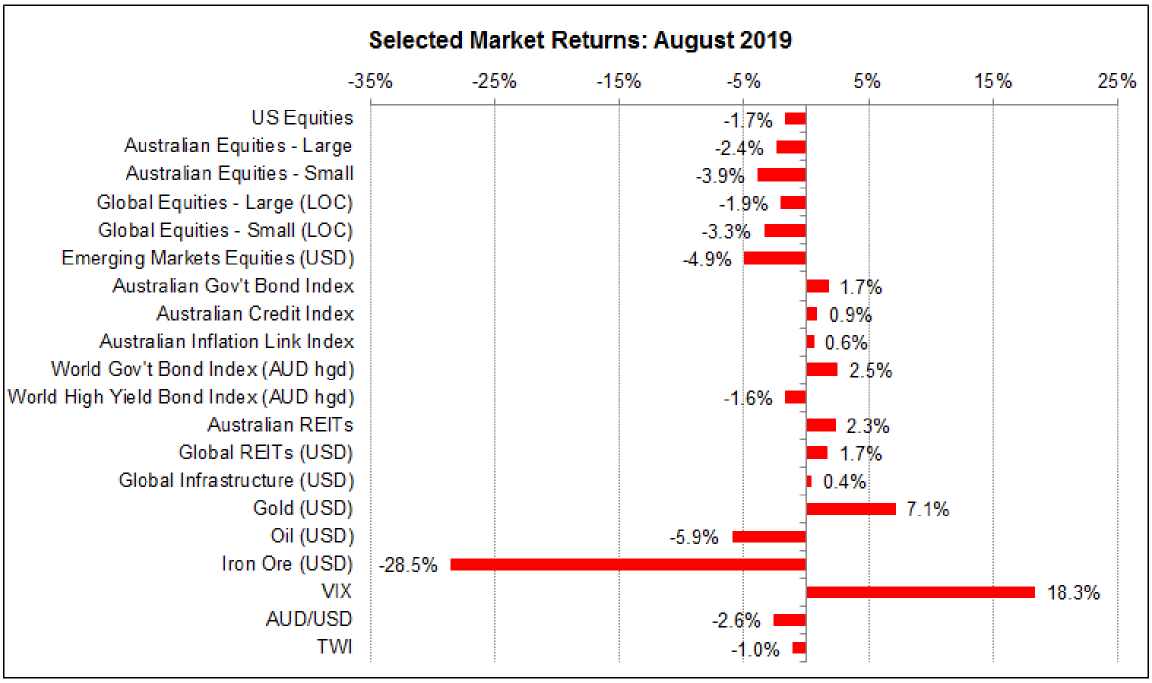
In summary

August was a turbulent month for global financial markets. The concerns that emerged at the end of July about the trade dispute between the US and China, and how much the Fed might cut rates, spilled over into August. Fears of global recession intensified, yield curves flattened further and equity markets suffered significant falls. However, it was not all bad news and by the end of the month equity markets had recovered much of their losses to finish the month only a few percent down.

The volatility was exacerbated by the seasonal thinness of trading conditions with Northern Hemisphere summer holidays, and a litany of sensationalist headlines in the popular media. Underlying all this is a high degree of uncertainty among investors about the global economy. Data continued to show manufacturing sectors around the world bearing the brunt of the trade dispute and Brexit, while services sectors and households are still in fair shape. Central banks around the world have either eased policy further, or flagged imminent policy changes, notably in Europe. The Reserve Bank of Australia has kept the cash rate at 1% but reiterated that it can fall further if required. The US and German governments said they are considering fiscal stimulus for their economies.

The general air of uncertainty and caution around global markets has been compounded by developments in Hong Kong, in the UK with Brexit, in Italy with the government collapsing and in Argentina with surprise election results triggering a fall of over 30% in the equity market in one day.

August was a difficult month for equities as trade wars reignited fears of global recession



Source: Thomson Reuters

Key developments in August

August was a turbulent month for global financial markets. However, it was not all bad news and by the end of the month equity markets had recovered much of their losses to finish only a few percent down. Emerging equity markets lagged developed markets in August, partly because of developments in Argentina.

The volatility we saw in August was exacerbated by the seasonal thinness of trading conditions with the Northern Hemisphere summer holidays, and by a litany of sensationalist headlines in the popular media. Underlying all this is a high degree of uncertainty among investors about what is happening with the global economy. Although the “inverse yield curve means recession in the US” story has had a lot of mileage in the media, not everyone is convinced. There is a tug-of-war going on in investors’ minds between:

- data showing the US economy is in good shape, but signs Europe and China are slowing
- central banks offering more policy easing, but fears low interest rates do not work anymore

On top of this, there is the erratic nature of Trump‘s handling of the trade dispute. This reflects both his personality, but also a deliberate tactical approach to try to keep the Chinese off-balance. Of course, this also keeps the markets off-balance and precipitates bouts of both selling and buying of equities according to the tweet of the day. Unfortunately, this does not look like ending any time soon. The trade dispute is part of a long-run process between the US and China and we are likely to see more developments like the retaliatory tariff increases in August and further gradual depreciation of the Chinese currency.

The trade dispute, as well as Brexit, is causing businesses to delay investment spending, which compounds any impact on growth from disruption to exports. Manufacturing sectors around the world are bearing the brunt of this, while service sectors are in better shape. That in turn is helps households and supports consumer spending which is such a larger part of the US economy, but a much smaller part of the Chinese economy. If the slowdown in manufacturing spills over into households via rising unemployment, then things will look much more worrying. However, that is not the case yet. Latest data show unemployment rates in major economies such as the US, Germany and Japan still at historically low levels.

Here in Australia, the unemployment rate is expected to rise in coming months, but the Reserve Bank again made it clear the cash rate can fall further to support employment and wages growth. Further rate cuts were made more likely by the Reserve Bank cutting its forecast for both growth and inflation. Senior RBA officials also said they have been looking at other steps they can take, such as QE type policies. Other central banks around the world are also on the easing track. The Reserve Bank of India cut its cash rate again and the ECB said it is preparing a stimulus package bigger than the markets currently expect. In China, the authorities announced some interest rate reforms which, in conjunction with their currency moves, create room for more monetary easing.

Of interest was a report in the German press that the government would be prepared to suspend its balanced budget rule and take on new debt to counter a possible recession. The US Administration also flagged the idea of fiscal stimulus through capital gains and payroll tax cuts.

Geopolitical developments in August added to markets’ general concerns:

- tensions between China and Hong Kong escalated, with no sign of either side backing down
- Brexit continues to consume the UK body politic. Boris Johnson’s latest moves to prorogue Parliament is a risky gambit that could end in a general election
- The Italian government collapsed, and talks are underway to form a new coalition;
- Surprise election results in Argentina pointing to a change in government triggered panic in markets there, with the equity market falling more than 30% in one day.