Fiducian Monthly Economic Commentary Report

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ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy has been able to sustain moderate growth despite the implementation of tight monetary policy by most of the world's major central banks over the past two years in an attempt to contain inflation. While inflation remains above target for most economies, the IMF is expecting central banks to be able to begin reducing official interest rates potentially in the second half of this year. As such, the IMF is forecasting 'soft landings' (no recession) for most of the major economies.

The global economy has been expanding at a moderate rate despite severe measures taken over the past two years by most of the world's major central banks to counter what had been rising inflationary pressures. As the International Monetary Fund (IMF) noted in its 31 January 2024 report, 'amid favourable global supply developments, inflation has been falling faster than expected'. Furthermore, the IMF is expecting inflation to continue to steadily decline, especially in the advanced economies, with the challenge being to 'manage the final descent of inflation to target, calibrating monetary policy and (ultimately) adjusting to a less restrictive stance'. This implies that not only are further increases in interest rates unlikely, but that in the IMF's words, its 'projections are for policy rates to remain at current levels for the Federal Reserve (the US), the European Central Bank and the Bank of England until the second half of 2024, before gradually declining as inflation moves closer to targets'. Given this forecast, 'the likelihood of a hard landing has receded' and 'the path to a soft landing has been opened', implying that global recession is now unlikely.

In the case of the US, inflation readings have come down significantly over the past 18 months, despite unemployment rates remaining low and growth being sustained. Across the developed world, however, economic activity is mostly weak and growth is forecast to be under the long-term trend rate for some time.

In the case of the US, the central bank (the 'Fed') last raised rates on 25 July 2023 to the range of 5.25% to 5.5%. 'Fed' Chairman, Jerome Powell, stated on 1 March that 'we view the policy rate as likely at its peak for this tightening cycle'. On 20 March, he noted that the 'Fed' 'does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent'. More broadly, tight monetary policy has been effective in slowing activity and the IMF is forecasting global growth of 3.1% this year and 3.2% for 2025 and only 1.5% and 1.8% for the advanced economies, noting that 'with the likelihood of a hard landing receding, risks to the global outlook are broadly balanced'.

AUSTRALIAN ECONOMY

The Australian economy in the December quarter remained in a per capita recession, which it entered in the first half of 2023. Household spending has been curtailed but tight monetary policy has also pushed inflation lower.

The Australian economy was weak again in the December quarter, growing by only 0.2%. On a per capita basis, it remained in recession, contracting for the third quarter in a row (by 0.3%), with output also likely to have been weak in more recent months. The key factor driving this slowdown has been rate rises by the Reserve Bank. These have weighed on household spending, with discretionary spending down 1.6% for the year. In January, the annual inflation rate dropped to 3.4% (and 0.7% for the quarter).

MARKETS

Major share markets fell heavily in 2022 but then experienced heavy volatility before rising sharply from October last year. Some markets look cheaper than others, including European markets and global small cap markets, while the US market appears more fully valued, although narrowly based.

Most share markets have been on an upwards trend since last October on the assumption that interest rates had peaked and would soon begin to be reduced. This has been particularly supportive of the more interest rate sensitive sectors of the market, including the technology and property sectors. This year, over the period to 27 March, market movements have included rises of 10% for the broad US market (S&P500), 9% for the technology-focused Nasdaq, Germany 10%, France 9%, the UK 3%, Japan 22%, China 1% and Australia 3%. The US market appears fully valued but most others still appear attractively priced, especially small caps, assuming that interest rates soon begin to decline.

Major sovereign bond markets saw yields rise after the end of 'quantitative easing' in 2022. However, more recently, slow growth in key economies has encouraged investors back into this 'safe haven'.

Major sovereign bond markets have been volatile in recent months after yields trended upwards from historical lows set during the pandemic in 2020. The US 10-year Treasury bond yield fell to 0.54% on 9 March 2020 but touched 5.0% in October last year before sliding again. On 27 March this year, it was 4.19%. Similarly, the Australian 10-year bond yield was 0.57% on 8 March 2020 but was 4.00% on 27 March 2024. Some bond markets could see yields fall further (and prices rise) over coming months if growth remains soft.

FIDUCIAN FUNDS

Fiducian's diversified funds are slightly above benchmark for growth assets (shares and property). Bond holdings have been increased and cash reduced.

Fiducian's diversified funds are currently slightly above benchmark for international shares, domestic shares and listed property. Exposure to bond markets was lifted last year to around benchmark, while cash holdings have been lowered.

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