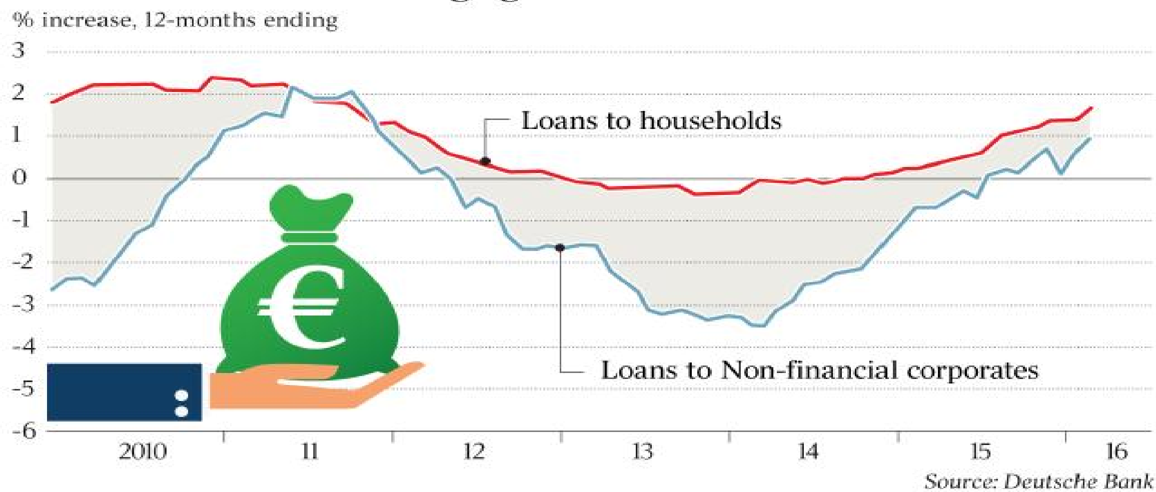
Wake up, the global economy is stirring

- THE AUSTRALIAN
- APRIL 12, 2016 12:00AM
- DON STAMMER



My previous column, "Trust me, monetary policy hasn't lost its mojo (March 29)", attracted an unusually large response from readers. That's welcome; there's no fun in dropping a pebble into the journalistic lake and not seeing any ripples.

I'd written on whether or not easy monetary policy will soon lift economic growth and raise inflation from today's modest rates. It's becoming a big issue in investment markets. The majority of readers who responded disagree with my assessment that monetary policy still packs a reasonable punch — at least in countries where banks have been recapitalised.

Indeed, the majority view of investors around the world seems to be that neither borrowers nor lenders will respond to the super-low interest rates and the abundant liquidity central banks are creating.

The widely held expectation in markets is for the persistence of the "new normal" of sluggish growth and negligible inflation. In this view, bond investors can expect small but mostly positive returns; share investors should anticipate only modest returns, even over the long term; and cycles are a thing of the past.

Certainly, global growth has been sub-par since the global financial crunch, despite the highly accommodative settings in monetary policy. But are bigger waves starting to form in the global economy and investment markets? Consider these points:

1. Financial crises always reduce the impact of monetary policy for a time, because of the erosion of confidence and because the circulation of credit slows.

2. For an accommodative setting in monetary policy to deliver a useful boost to spending and inflation, banks need to step up their lending and borrowers to increase their indebtedness. That's now happening in the US, Britain and Australia (and, to a limited extent also in China).

Europe has been slow to recapitalise its banks but, as the chart shows, bank credit is starting to flow again, and that's before effects come through from the latest monetary package of March 10. Japan, however, is expecting a delay in achieving the 2 per cent inflation it has been hoping for.

3. Labour markets have tightened noticeably in most of the big economies, and these gains would reflect, in part, the easy settings in monetary policy. US wages, which have been quiescent for some time, are starting to move up (the average increase was an annual rate of 2.7 per cent in the three months to March). Investors will need to keep a close watch on US wages and inflation. Certainly, investment markets will be highly sensitive to any numbers that run well above expectations.

4. The US central bank says it "anticipates that only gradual increases in the (cash) rate are likely to be warranted in coming years".

That's because the recent lift in the rate of US inflation may not "prove durable" and because the "fragile" global economy could threaten the US recovery. These commitments, along with the Fed's desire to make future hikes in the cash rate "data dependent", could result in another episode of changes in monetary policy that turn out to be "too little and too late".

5. I'm not alone in my view that investors now need to allow for prospects of stronger-than-currently expected recoveries in growth and inflation. Look at these extracts from a recent report of the research team at ANZ Bank: labour markets in the G7 economies "are signalling a more mature recovery than many perceive"; "China's indicators are more positive" which "would be a surprise to consensus"; "headline inflation is set to turn quickly if oil genuinely has based as we expect"; and US inflation "is recovering".

This one is from Goldman Sachs in the US: "We think under our baseline case for the US and the global economy, a more cautious Fed coupled with the pursuit of reflationary policies by the European Central Bank and the Bank of Japan will support an increase in the market view of forward inflation."

Today's dominant view — that the global economy will continue on the "new normal" path of sustained low growth and negligible inflation — could soon be replaced by an awareness that significant cycles in global growth and inflation will soon be again part of investors' staple diets. Investors, be aware — and prepare.

Don Stammer chairs QV Equities, is a director of IPE, and is an adviser to the Third Link Growth Fund and Altius Asset Management. The views expressed are his alone.