FOUR ISSUES FOR INVESTORS TO KEEP ON THE RADAR IN 2018

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"The inevitable never happens. It is the unexpected always."
John Maynard Keynes (1883 -1946)

2017 was a year of surprises and shocks. This year is likely to bring its own remarkable events in economics and politics. So rather than trying to predict precisely the twists and turns of the future, here are four broad issues that investors should keep on the radar in 2018.

1. The exuberant US share market may not last.

Last year Wall Street reached record highs, boosted by rising corporate profits and the prospect of lower taxes under President Trump. The unemployment rate, at 4.1%, was the lowest in the past decade. Retail spending surged, while inflation remained modest. The US Federal Reserve (Fed) signalled that future US interest rate rises should only be 'gradual'.

However, in several possible scenarios, this fairy tale could easily fracture. First, President Trump could face the spectre of impeachment as a result of the Mueller investigation into collusion with Russia during the 2016 election campaign. The US mid-term elections in November 2018 could also see Republicans lose control of Congress. If the White House is under siege, the much-publicised 'permanent' corporate tax cuts may become only 'temporary'.

Second, the Fed's guidance for gradual interest rate rises isn't a guarantee. The Fed has a new Chair, Jerome Powell, and new committee members. If inflation starts to rise, the Fed could surprise with more aggressive interest rate rises in 2018.

Any of these developments in the US could deflate the buoyant share market.

2. Political challenges could threaten China's growth.

China's economic growth has been remarkably strong and stable in recent years, averaging near 7%. Yet this masks some deep fault lines. With robust growth in borrowing, China's debt obligations have surged to 242% of nominal GDP.[1]

Over the past year, credit conditions in China have become tougher to slow this debt locomotive. China's government has the ability to mitigate any debt crisis by bailing out the state-owned enterprises, local governments and banks which have exceeded their authority. However, given President Jinping's anti-corruption campaign, there may not be the political will for this. If there is no bail-out, the current comfortable expectations of China's economic and financial stability could be challenged in 2018, with repercussions for the global economy.

3. Europe faces considerable economic and political risks, and the geopolitical climate elsewhere remains troubling.

After recent solid economic growth, in 2018 the European Central Bank will scale back its long-term program to stimulate lending by purchasing assets. However, some other signs are much less healthy. In particular, unemployment rates remain high in countries like Greece (21% unemployment), Spain (17%), Italy (11%) and France (9%). The exit of some countries from the European monetary system, or even the European Union, are still possibilities in 2018.

Spain's political problems with Catalonia, Italy's general election in March 2018 and even German Chancellor Angela Merkel's difficulties in forming a coalition government all signal that Europe political climate is more fragile than investors may assume.

Beyond Europe, there is a shopping list of major geopolitical risks that will continue in 2018. The hostile relationship between the US and North Korea, Syria and Iraq teetering on the edge of becoming failed states and the simmering tension between Iran and Saudi Arabia are all highly unpredictable situations.

4. In Australia, there are hints that interest rates could rise.

The cash interest rate has been set at the remarkably low rate of 1.5% since mid-2016. Many investors expect it will be stuck there throughout 2018. Australia's slow wages growth and mild inflation have seemed to give the Reserve Bank of Australia (RBA) little choice but to keep interest rates low.

However, there are some early signs that interest rates could move higher. Australia's unemployment rate is grinding downwards due to stronger jobs growth. Workers are beginning to feel more secure about their jobs, which should lead to a revival in wage pressures. As a result, it seems likely that the RBA will contemplate raising interest rates later in 2018. An increase in rates would come as a shock to those borrowers who are carrying a high level of household debt on the assumption that interest rates will stay low.

[1] Source: The International Monetary Fund at www.imf.org/en/News/Articles/2017/08/09/NA081517-China-Economic-Outlook-in-Six-Charts