July 2008

Markets and Economies Report

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Global economy

Review: The global economic slowdown continued in July, not helped by a further surge (since reversed) in oil prices into mid-July. US data remained weak, particularly in terms of the housing sector, which still faces significant difficulties. During July, this was evident in further declines in housing sales, elevated vacancy rates and falling house prices. Declining employment reflected continued weakness in the US labour market. Inflationary pressures persisted with the US CPI and producer price index both slightly higher than expected. An anecdotal assessment by the US Federal Reserve (Fed) suggested slower economic activity and elevated price pressures in the near term. The US Government announced a plan to increase the lines of credit to embattled mortgage finance giants Fannie Mae and Freddie Mac. The Fed provided further support to the US financial sector by extending its emergency lending facility for investment banks. Japanese economic data also softened. July saw a further fall in the Tankan business conditions survey, weaker exports, falling housing starts and lower construction spending. June quarter GDP fell, suggesting Japan may have entered a recession. Inflation readings rose, with Tokyo's annual headline inflation reaching a decade high. However, core inflation remained subdued at 0.3%. The Bank of Japan opted to keep its benchmark interest rate on hold at 0.5% on concerns about the downside risks to growth. On a positive note, Japan's machinery orders rose strongly. China's inflation concerns continued, although there are tentative signs that price pressures are starting to moderate. Chinese data showed slowing inflation and a moderation in growth to 10.1%, down from a peak of over 12.0% last year. European data were also largely soft in July, with sharp falls in Euro-zone new industrial orders and business conditions readings. Industrial production weakened and UK consumer confidence fell to its lowest level since 2004. As expected, the ECB raised interest rates to 4.25% after June's high CPI, but has since shown concern about slowing economic growth. Both the UK and Europe face uncomfortable inflation pressures in combination with historically low investor and consumer confidence.

Outlook: Growth is likely to slow further, but this will lead to falling inflation and interest rates which will aid recovery in 2009.

Australian economy

Review: Australian economic data remained weak, providing further evidence of a moderation in domestic demand. Business confidence, manufacturing and services softened and consumer confidence fell to a 16-year low. The housing sector slowdown continued with data for building approvals and house prices falling. Employment data were strong, although the trend has clearly moderated and leading labour market indicators point to softer employment growth ahead. Inflation accelerated with June's headline CPI rising to 4.5% yoy. Despite this, the RBA kept interest rates on hold at 7.25%, and has since signalled lower rates ahead. Retail trade is now slowing sharply and Australia's terms of trade received a significant boost.

Outlook: Domestic economic conditions are likely to slow this year. However, while the risk of recession has increased it should be avoided due to a strong pipeline of investment projects and the latest increases in iron ore and coal prices.

International shares

Review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -1.71% in local currencies (or -0.3% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -0.8% for the month. In the Euro-zone, the Eurostoxx Accumulation Index returned -1.7%, while the UK FTSE 100 Accumulation Index returned -3.7%. Japan's shares were also down, with the Topix Accumulation Index returning -1.2%, while Chinese shares were in the minority in positive territory, returning 0.7% in July.

Short-term outlook [six to 12 months]: Turmoil may continue in the short term on US recession worries. However, global shares are likely to provide reasonable returns on a 12-month view, given the likelihood of further monetary easing and reasonable fundamental valuations.

Medium-term outlook [five to ten years]: Modest dividend yields and a slowdown in profit growth to around nominal GDP growth will constrain the returns from mainstream global shares to around 8% per annum on average.

Australian shares

Review: The Australian share market was again weaker in July, suffering from deteriorating sentiment on concerns about the financial sector, profit downgrades and bad debt provisioning. Further signs of a slowing economy also pushed the market lower, with the S&P/ASX 200 Accumulation Index returning -4.6% in July.

Short-term outlook: The Australian share market is likely to remain volatile over the next few months. However, shares should improve into year-end. Valuations remain attractive and profit growth should remain positive, boosted by the resources sector.

Medium-term outlook: Reflecting a solid dividend yield and reasonable growth prospects, medium-term returns of around 10% per annum are expected.

Listed property securities

Review: The S&P/ASX Property 200 Accumulation Index returned -5.0% in July. The central theme for the sector during the month was financial year reporting. The market remains focused on gearing levels, earnings, the cost of and ability to refinance maturing debt, capitalisation rate expansion and distribution cuts. GPT Group's update disappointed the market, with the company downgrading net income by around 27%, citing deterioration in global markets. Mirvac Group and Australand announced changes to their distribution policies. The latter also reported an operating profit of $68 million and proposed a one-for-one renounceable rights issue. Macquarie CountryWide Trust restructured one of its debt facilities to eliminate gearing and interest cover ratios at the trust level. The office sub-sector was the notable outperformer in July, returning 14.8%. This was followed by retail, with a return of 0.2%. The industrial and diversified sub-sectors were the worst performers, returning -16.2% and -15.0%, respectively.

Short-term outlook: The next six months are likely to remain volatile due to worries about gearing levels. However, conditions should improve on a sustainable basis into year-end.

Medium-term outlook: Now solid yields and moderate growth prospects mean medium-term returns of around 10% or 11% per annum are expected.

International bonds

Review: International bond yields were lower in July as concerns about the global growth outlook mounted. The US ten-year bond yield lost 2 basis points (bps) to 3.95% and Japan's ten-year bond yield fell 6 bps to 1.54%. In Europe, the UK ten-year bond yield dropped 32 bps to 4.81% and Germany's ten-year bond yield fell 26 bps to close at 4.36%.

Short-term outlook: Bond yields may fall further in the short term on the back of the global downturn.

Medium-term outlook: AMP Capital expects low returns from global bonds, reflecting low bond yields.

Australian bonds and cash

Review: The Australian bond market was volatile in July. Yields gained mid-month but the Australian bond market rallied towards the end of July, influenced by weakening domestic data and growing credit concerns. The three-year bond yield fell 54 bps to close at 6.16% after opening at 6.70%, while the ten-year bond yield lost 23 bps, opening at 6.45% and closing at 6.22%. The spread between Australian and US ten-year bond yields narrowed in July, finishing the month at 227 bps. July saw short-dated bank bill yields fall significantly as concerns about the downside risks to domestic growth increased. The three-month bank bill rate both opened at 7.84% before closing 7.76%, though traded in a range between 7.71% and 7.83%. Six-month bank bills traded in a wider range, opening at 7.96% and closing at 7.82%, though trading as high as 8.18% during the month.

Short-term outlook: AMP Capital's view is that Australian bonds will deliver modest returns over the next year.

Medium-term outlook: Returns from local bonds over the medium-term are also expected to be modest, reflecting low yields.

Australian dollar

Review: Despite initial gains, the Australian dollar (A$) closed July lower against the US dollar (US$), the Japanese yen (JPY) and the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A$ closed the month at 94.13 US cents (down 1.8% from 95.84 US cents) and JPY101.56 (down 0.1% from JPY101.67). The TWI closed the month at 72.2 (down 1.6% from 73.4).

Short-term outlook: The next few months are likely to be weak with the A$ buffeted by worries about local and global growth, falling local interest rates and a correction in commodity prices.

Medium-term outlook: The A$ should remain solid over the medium term, helped by high commodity prices.

Key financial markets

	31 July 2008	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	32,330	-4.6%	-15.6%
MSCI World (ex-Aust Accumulative/ unhedged in A$)	3,366	-0.3%	-18.9%
US S&P 500 Accumulation Index	2,014	-0.8%	-11.1%
Dow Jones Eurostoxx Accumulation	470	-1.7%	-22.3%
UK FTSE 100 Accumulation Index	3,221	-3.7%	-11.6%
Japan Topix Accumulation Index	1,559	-1.2%	-22.3%
S&P/CITIC 300 Total Return Index	2,342	+0.7%	-35.8%
S&P/ASX 200 Property Accum. Index	25,816	-5.0%	-36.5%
UBS Warburg Global Real Estate Investor Index	243	+1.1%	-14.9%
Aust 90-day bank bill yield	7.76%	-8 bps	+114 bps
Aust 10-year bond yield	6.22%	-23 bps	+19 bps
US 10-year bond yield	3.95%	-2 bps	-79 bps
A$ in US cents	94.13	-1.8%	+9.8%
Trade-weighted index	72.2	-1.6%	+4.9%

Contact us

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