Investment Strategy & Economics

Weekly Market & Economic Update – week ending 6 August 2010

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Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
US – Institute for Supply Management manufacturing survey, July	index	55.5	56.2	⇓
Australia – Retail sales, June	mom	+0.2%	+0.2%	⇔
US – Institute for Supply Management non-manufacturing survey, July	index	54.3	53.8	⇑
Australia – Trade balance, June	mom	+A$3.54 billion	+A$1.65 billion	⇑
China – Non-manufacturing purchasing manager's index, July	index	60.1	57.4	⇔

Financial markets

Indicator	Friday, 6 August 2010	Friday, 30 July 2010	Weekly change	6 August 2009	12-month change
S&P/ASX 200 Index	4,566	4,542	+0.5%	4,326	+5.5%
S&P/ASX 200 Property Trusts	870	865	+0.7%	803	+8.4%
US S&P 500	1,122	1,126	-0.4%	997	+12.5%
Dow Jones Eurostoxx	265	269	-1.3%	247	+7.5%
UK FTSE 100	5,332	5,397	-1.2%	4,691	+13.7%
Japan TOPIX	861	851	+1.2%	958	-10.1%
CITIC/S&P 300 China A	2,449	2,461	-0.5%	3,031	-19.2%
MSCI (ex-Aust/in LC)	820	807	+1.6%	756	+8.5%
Aust 90-day bank bill yield	4.75%	4.78%	-3 bps	3.28%	+147 bps
Aust 10-year bond yield	5.09%	5.18%	-9 bps	5.67%	-58 bps
US 10-year bond yield	2.82%	2.96%	-14 bps	3.75%	-93 bps
Oil – West Texas Crude	US$80.70	US$81.34	-0.8%	US$71.94	+12.2%
A$ in US cents	US$0.9187	US$0.9127	+0.7%	US$0.8409	+9.3%
TWI	70.4	69.4	+1.4%	66.5	+5.9%

Major upcoming global economic releases and events

Date	Data/Event	Units*	Previous	Market Forecast
10 August	Japan – Machine orders, June	mom	-9.1%	+5.4%
11 August	Australia – Westpac/Melbourne Institute consumer sentiment survey	-	+11.1%	n/a
11 August	China – Consumer price index (CPI or inflation), July	yoy	+2.9%	+3.3%
12 August	Australia – Unemployment rate, July	mom	5.1%	5.1%
13 August	US – Retail sales, July	mom	-0.5%	+0.4%

*Month-on-month (mom); quarter-on-quarter (qoq); year-on-year (yoy); seasonally adjusted annual rate (saar)

Headline developments of the past week

- The past month has seen share markets and other growth assets climb a wall of worry. While economic indicators suggest global growth has slowed, there is no sign of the 'double dip' recession feared a month ago. In fact Europe, which was the initial source of this year's instability, has surprised on the upside.
- Global earnings have remained strong, with 76% of US companies and 62% of European companies to have reported for the June quarter coming in better than expected. While the earnings results are backward looking, they do tell us that the corporate sector globally is in good shape. This should augur well for business investment, employment, dividends and merger and acquisition activity, providing an offset to poor household and/or public sector balance sheets.
- In Australia, the Reserve Bank (RBA) left interest rates on hold. However, with the RBA still forecasting growth to rise above trend over the next two years and inflation expected to bottom in the top half of the RBA's target range before starting to rise again, it's clear the Bank retains a tightening bias. We still expect occasional and gradual rate hikes to resume by year end.

Major global economic releases and implications

- US economic data was mixed. On the negative side, pending homes sales fell further in July, initial jobless claims rose and weekly retail sales data was weaker than expected. On the positive side, while the Institute for Supply Management's (ISM) manufacturing conditions survey fell in July, it fell by far less than expected and remains at levels consistent with solid growth. The ISM non-manufacturing conditions survey rose in July, as did weekly mortgage applications; suggesting that the housing sector may have stabilised following its post-tax credit slump. Also, various labour market indicators are pointing to continuing private sector jobs growth. The basic picture is that while momentum in the US economy has slowed down, it doesn't appear to be collapsing back into recession.
- Final European business conditions indicators for July showed an improvement on June, particularly for the manufacturing sector, with the earlier weakness in the euro playing a role. German factory orders also rose.
- Chinese business conditions surveys painted a mixed picture of the economy, with manufacturing softening but non-manufacturing improving. The key message is that Chinese growth is slowing but not collapsing.

Australian economic releases and implications

- Australian economic data was mixed. While the Australian Bureau of Statistics said house prices rose 3.1% in the June quarter, this should be seen as a lagging indicator as the more timely RP Data-Rismark house price series is pointing to weakness. Housing sector weakness was clearly evident in new home sales and building approvals, both of which fell in June. Retail sales rose modestly in June while the news on the trade front was very good with a record surplus in June.

Major market moves

- Share markets rose as economic data came in better than feared and profit results remained favourable. Commodity prices and commodity currencies like the A$ also continued to push higher. Wheat prices rose 8.9% amid threats to supply following adverse weather events in the northern hemisphere, which is great news for Australian farmers but not so good for consumer price inflation. However, any impact on inflation is likely to be temporary and central banks will know this.

What to watch in the week ahead?

- In the US, the Federal Reserve is expected to leave interest rates unchanged but the big issue is whether it will step up quantitative easing in the face of the "unusual uncertainty" regarding the economic outlook.
- Chinese economic data for July will be watched closely, with industrial production and fixed asset investment likely to slow further, retail sales growth likely to remain strong and inflation likely to rise to around 3.4% from 2.9% on the back of the flood-driven rise in food prices.
- In Australia, the July labour market report will likely show a further gain in employment of around 25,000 jobs, pushing the unemployment rate down to 5.0%.

Outlook for markets

- The very short term outlook for shares is mixed. Strong profit results in the US and Europe have provided a lift and the Australian profit reporting season now getting underway may provide a similar lift for Australian shares this month. Against this, double dip concerns are likely to persist for a while and suggest that we may still see another bout of weakness into the seasonally weak months of September and October. However, we remain of the view that a double dip recession globally will be avoided, and with shares very good value, monetary conditions set to remain favourable and China likely to start relaxing its tightening measures in the next few months, shares are likely to stage a strong rally in the December quarter and through 2011.
- The A$ is likely to remain volatile in the short term but we see more upside on a six to 12 month view as it becomes clear that the global recovery is continuing, commodity prices remain strong and Australian interest rates remain well above global rates.
- Low yields are pointing to poor medium-term returns from government bonds, particularly given worries about excessive public debt.

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