

Investment Strategy & Economics

Weekly market & economic update

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WEEK ENDING 6 JANUARY 2012



Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
US - consumer confidence, December	index	64.5	55.2	↑
US - unemployment, December	actual	8.5%	8.7%	↓
US - New Home Sales, November	actual	315,000	315,000	↔
China – HSBC purchasing manager index, December	index	52.5	52.5	↔
Australia – Trade balance, November	actual	A\$1.380b	A\$1.418 b	↓

Financial markets

Indicator	Friday, 6 January 2012	Friday, 30 December 2011	Weekly change	6 January 2011	12-month change
S&P/ASX 200 Index	4,143	4,057	2.1%	4,725	-12.3%
S&P/ASX 200 Property Trusts	811	778	4.2%	840	-3.5%
US S&P 500	1278	1,258	1.6%	1,274	0.3%
Dow Jones Eurostoxx	225	226	-0.4%	278	-19.1%
UK FTSE 100	5650	5,572	1.4%	6,020	-6.1%
Japan TOPIX	730	729	0.1%	925	-21.1%
CITIC/S&P 300 China A	1,927	1,973	-2.3%	2,654	-27.4%
MSCI World (ex-Aust/in LC)	844	834	1.2%	912	-7.5%
Aust 90-day bank bill yield	4.45%	4.47%	-0.02%	2.98%	1.47 bps
Aust 10-year bond yield	3.80%	3.67%	0.13 bps	5.59%	-1.79 bps
US 10-year bond yield	1.96%	1.88%	0.08 bps	3.40%	-1.44 bps
Oil – West Texas Crude	101.56	98.83	2.8 bps	88.38	14.9%
A\$ in US cents	1.028	1.0209	0.7%	0.9947	3.3%
TWI	76.2	75.5	0.9%	74.8	1.9%

Major upcoming global economic releases and events

Date	Data/Event	*Units	Previous	Forecast
12 January	UK – Bank of England interest rate announcement, January	actual	0.5%	0.5%
12 January	Europe – European Central Bank interest rate announcement, January	Actual	1.0%	1.0%
12 January	US – Retail sales, December	mom	0.2%	0.2%
12 January	China – Producer price index, December	yoy	+2.7%	+1.6%
12 January	China – Consumer price index, December	yoy	+4.2%	+4.0%

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

Headline developments of the past week

- > **Europe's debt debacle has continued into 2012 with mixed responses in Global share markets this week.** For the years opening, European shares have ranged between the 'robust' (German shares up +3.4%) and the 'also rans' (Spain down -2.8 %). Given that Europe's banking and sovereign debt crisis is yet to be resolved and the politicians are planning another round of summit meetings, European shares seem set for a difficult 2012.
- > **The weaker European nations are struggling with the task of trimming their large budget deficits.** Spain had originally targeted a budget deficit of approximately -6 % Nominal gross domestic product (GDP) in 2011 but this appears likely to be closer to -8% GDP. Spain's new conservative government, after the November 2011 election, has announced additional tax hikes of €6 billion and €8.9 billion in spending cuts to reduce the budget deficit by 1% of GDP.
- > **By contrast, American and Australian shares have had a more promising opening week for 2012.** The benchmark US share index in the S&P 500 has risen by +1.9% while Australia's S&P/ASX 200 index is up +1.3%.

Major global economic releases and implications

- > **European business surveys continue to indicate a recession.** The purchasing managers index (PMI) survey for December did rise marginally by +0.5 to 46.9 but suggests that European industrial production is still contracting.
- > **America's Institute for Supply Management (ISM) business surveys suggests moderate US growth in the final quarter of this year.** December's ISM survey for manufacturing rebounded by 1.2 points to 53.9, the highest reading in six months. The ISM non-manufacturing survey improved by +0.6 points to 52.6 in December and is indicative of modest US growth. Essentially these ISM surveys suggest that the US economy ended 2011 with activity expanding at a pace of +2 % real GDP.
- > **America's labour market recorded solid jobs growth in December of +200,000 compared to November's result of +120,000.** Private sector hiring was 212,000 in December. America's unemployment rate fell by 0.1% to 8.5% in December the lowest level in 3 years.
- > **The US Federal Reserve's (FED) meeting minutes for December provided some interesting comments.** The FED noted that there were a number of factors restraining US economic growth such as *"fiscal and banking issues in the Euro area"* as well as *"fiscal tightening in the United States, high levels of uncertainty among households and businesses, the weak housing market and household deleveraging"*.
- > **Yet US consumer confidence rose to the highest level in more than five months.** The Bloomberg Consumer Comfort Index climbed to -44.8 in the period ended 31 December 2011, the best reading since mid-July 2011. There appears to be some improvement in the US labour market. Applications for jobless benefits decreased by 15,000 to 372,000 according to Labor Department figures.

Australian economic releases and implications

- > **Australia's central bank's measure of private sector credit growth shows that both consumers and business remain cautious when borrowing.** Personal credit rose marginally by 0.1% month-on-month (mom) in November but remains at -1.1% year-on-year (yoy). Australian consumers appear to have minimal interest to borrow for spending purposes or to acquire assets. Housing credit is more solid (+0.5 % mom in November) but annual growth at +5.7% is still a fraction of the 15% pace set in the decade prior to 2007. Business credit was flat mom in November and has barely expanded by +0.9% over the past year. Arguably, this sluggish corporate borrowing also reflects a preference to use retained earnings rather than use external funding sources..
- > **Australia's trade surplus narrowed in November** to A\$1.38 billion from October's A\$1.42 billion. While only a marginal contraction in the surplus, the trade result does indicate tougher global trading conditions for exporters over recent months. Exports were almost flat (+0.2% mom) as lower iron ore commodity prices apparently trimmed sales revenue. Imports were also muted (+0.4% mom) but this largely reflects weaker consumer good imports (-0.3% mom) given retailer's diminished expectations for spending activity. By contrast, capital goods imports were strong in November (+5.7% mom) with the mining investment boom.

Major market moves

- > **Europe's currency continues to edge lower as markets question the integrity of the European monetary system.** The Euro has fallen by -1.3% this week against the American Dollar. Indeed the Euro is now at a record lows against the Australian Dollar since the introduction of the Euro in 1999 (Australian dollar versus Euro is now above 0.80).
- > **Oil prices remain bad given concerns over Iran's intentions in the Strait of Hormuz and potential threat to global energy supply.** Brent Crude has risen by +4.7% over the past week to US\$112.5 per barrel.

What to watch in the week ahead?

- > **US retail sales for December are to be released next Thursday** and are an important measure of consumer spending. The US Federal Reserve releases their anecdotal survey of the American economy (known as the 'beige book') which typically gives some insights on current regional performances.
- > **The European Central Bank (ECB) and the Bank of England have monetary policy meetings next Thursday.** While no interest rate changes are expected, there will be particular interest in the ECB President's comments on the European banking & sovereign debt crisis and how the response of the central bank.
- > **China is set to release critical economic activity data next week**, including real GDP for the December quarter, industrial production and retail sales for December as well as December CPI inflation. The key interest is whether China's economy continues to slow given tighter monetary policy in 2010-2011 and recent weaker global demand for its exports, particularly in Europe. A further moderation of inflation pressures in December would be welcome as this could give China scope to cut interest rates sooner.

Outlook for markets

- > **Global shares are very cheap compared to corporate profits as well as relative to government bond yields.** Yet Global shares have to battle the current prevailing headwinds of Europe's banking and debt crisis, doubts on the durability of the US recovery as well as concerns that Asia's growth is slowing sharply. While Global Shares are likely to tread water in the short term given the prevailing pessimism, 2012 should ultimately prove a better year than 2011. Global share have factored in a significant amount of stress as indicated by forward price to earnings multiples which are now 10.2 times for Global shares compared to 12.4 times a year ago. For Australian shares, the forward PE is now 10.6 times compared to 13 times a year ago. The Australian ASX 200 is expected to rise towards 4800 by the end 2012
- > **Global Bond yields are very low in the core countries of America, Germany, Britain and Japan.** This suggests low returns unless Europe's debt crisis intensifies further and a global recession transpires. Australian government bonds are relatively more appealing with higher yields than these global bonds. Yet Australian corporate debt is an even better investment proposition if one needs income or is worried about shares.
- > **Cash & term deposits should become less attractive in 2012** with the RBA likely to lower Australia's official cash rates by a further 0.25% to 4.0 % in February 2012.
- > **Commercial property returns are likely to be solid in 2012 reflecting yields around 7%.** This suggests that only modest capital growth can generate a decent annual return.
- > **The \$A is likely to have some large price swings in 2012 but generally remain solid.** Australia as one of the very few countries with a stable AAA rating is perceived as a "safe haven" with Europe's sovereign debt woes.