June 2008

Markets and Economies Report

by Dr Shane Oliver, Head of Investment Strategy & Chief Economist

Global economy

Review: Further signs of a global economic slowdown were evident in June. In the US, consumer sentiment and industrial production fell, while the Fed's beige book of anecdotal evidence reflected weakness in economic activity levels. The US housing sector remained under severe pressure with mortgage delinquencies and foreclosures reaching 29-year highs, while housing construction, new home starts and house prices all fell. Nonetheless, the Fed left the federal funds rate on hold at 2.0%, precariously balancing the downside risks to growth and the upside risks to inflation. The US consumer price index increased 0.6% in May on surging energy and food prices but inflation remained benign. Positively, an encouraging rebound in the June ISM manufacturing survey was recorded, as was a bounce in US nominal retail sales. Furthermore, March quarter real GDP growth was revised slightly upwards from +0.9% to +1.0% (seasonally adjusted annual rate). Hence, in technical terms, the US economy has so far avoided recession. Japan's economic woes continued in June as household spending fell and business conditions deteriorated. Worrying signs of the adverse impact of higher commodity prices on consumer spending and the labour market also appeared. Despite a stable unemployment rate, a leading indicator of the Japanese labour market softened suggesting a major slowdown. Japanese inflation came in at 1.3% over the year to May, but core inflation remained virtually non-existent. On the upside, Japan's export growth remained strong. Chinese economic data remained solid, with industrial production and fixed asset investment rising. This prompted the People's Bank of China to further tighten bank lending requirements. China's inflation moderated slightly in May. This is consistent with ongoing efforts by the authorities to slow the economy. European economic data were generally weak in June with business conditions and consumer confidence all slowing. Despite leaving interest rates on hold during the month, the ECB remains focused on inflation.

Outlook: Growth is likely to slow further, but the combination of US monetary easing, tax rebates and in emerging country growth should mean a long and deep global downturn is unlikely.

Australian economy

Review: Local data releases in June continued to point to slower economic growth. Consumer confidence fell to a 16-year low, new motor vehicle sales and housing starts declined and employment growth registered its first decrease since October 2006. However, unemployment remained steady at 4.3%. A gradual slowdown in domestic demand due to tighter financial conditions is now evident. The RBA left rates on hold at 7.25% and now appears more confident that demand growth is slowing. The trade deficit narrowed on higher coal and iron ore prices and lower imports.

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

International shares

Review: International share markets continued to weaken in June. Shares fell in response to ongoing strength in the oil price, higher bond yields and inflation concerns. Concerns about global economic growth and inflation also dragged down international share markets. In particular, financial shares slid as sub-prime related asset write-downs and credit losses mounted. The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -8.3% in local currencies (or -8.6% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -8.4% for the month. In the Euro-zone, the Eurostoxx Accumulation Index returned -11.7%, while the UK FTSE 100 Accumulation Index returned -6.8%. Shares in Asia were also down – Japan's Topix Accumulation Index returned -6.2%, while Chinese shares lost considerable ground, with the S&P/CITIC 300 Total Return Index returning -22.1%.

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 remained under intense pressure in June. A poor lead from global share markets, concerns about the financial sector and high inflation and the surging oil price all contributed to weakness during the month. The effects of tax loss selling and profit downgrades drove renewed risk aversion and also weighed on investor sentiment. The S&P/ASX 200 Accumulation Index returned -7.5% in June.

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 is likely to remain positive.

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 -10.9% in June, as financials generally remained under pressure. During the month, Goodman Group priced a £250 million (A$520 million) debt issue under its Euro Medium Term Note programme. The ten-year senior unsecured notes were priced at a fixed coupon rate of 9.75% per annum. Attractive market pricing, relative to the direct acquisition of property, prompted some merger and acquisition activity within the sector. The retail sub-sector was the best performer for the month; industrial was the worst performer.

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 mixed in June in response to the conflicting forces of risk aversion and inflation concerns. The US ten-year bond yield lost 9 bps to 3.97% and Japan's ten-year bond yield fell 16 bps to 1.60%. Conversely, the UK ten-year bond yield increased 14 bps to 5.13%, while Germany's ten-year bond yield added 21 bps to close at 4.62%.

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 again volatile in June as global inflation concerns affected credit market sentiment. Both three-year and ten-year bond yields finished the month down slightly after touching peaks in the middle part of the month. Bond yields rose initially on increased inflationary pressures and raised rate hike expectations in the US and Europe. However, the second half of June was in stark contrast as Australian bond yields fell on a renewed flight to quality. Australian three-year bond yields ended the month 3 bps lower to close at 6.70%, while local ten-year bond yields ended the month 8 bps lower to close at 6.45%. The spread between Australian and US ten-year bond yields finished the month marginally wider at 248 bps. June saw short-dated bank bill yields rise in response to increased inflation fears and end of financial year funding pressures.

The three-month bank bill rate opened at the month low of 7.70% and closed at 7.84%, though traded as high as 7.94%. Six-month bank bills traded in a wider range, opening at 7.92% and closing at 7.96%, though trading as high as 8.18%.

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: The A$ made further gains in June, closing the month up 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 June at 95.84 US cents (up 0.4% from 95.43 US cents) and JPY101.67 (up 1.1% from JPY100.54). The TWI closed the month at 73.4 (up 0.8% from 72.8).

Short-term outlook: The next six months are likely to be volatile with the A$ buffeted between worries about local and global growth, high local interest rates and high but uncertain commodity prices.

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

Key financial markets

	30 June 2008	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	33,875	-7.5%	-13.4%
MSCI World (ex-Aust Accumulative/ unhedged in A$)	3,376	-8.3%	-21.3%
US S&P 500 Accumulation Index	2,032	-8.4%	-13.1%
Dow Jones Eurostoxx Accumulation	478	-11.7%	-23.9%
UK FTSE 100 Accumulation Index	3,345	-6.8%	-11.6%
Japan Topix Accumulation Index	1,579	-6.2%	-24.4%
S&P/CITIC 300 Total Return Index	2,310	-22.1%	-24.9%
S&P/ASX 200 Property Accum. Index	27,166	-10.9%	-36.4%
UBS Warburg Global Real Estate Investor Index	241	-10.4%	-21.7%
Aust 90-day bank bill yield	7.84%	+5 bps	+140 bps
Aust 10-year bond yield	6.45%	-8 bps	+19 bps
US 10-year bond yield	3.97%	-9 bps	-105 bps
A$ in US cents	95.97	+0.7%	+13.1%
A$ Trade-weighted index	73.4	+0.8%	+6.5%

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

Financial Planners	AMP Capital's Investment Representative on 1300 139 267
Personal Investors	Your Adviser or Financial Planner
Wholesale Investors	AMP Capital's Client Service Team on 1800 658 404

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