

# Market and Economics Report



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

## Global economy

**Review:** The global economy continued to demonstrate signs of improvement in May. Nonetheless, US real gross domestic product (GDP) fell -2.6% year-on-year (yoy), the deepest annual decline since the 1981/82 recession. The 'stress tests' on 19 major US banks identified 10 banks that required US\$75 billion in additional capital to guard against a more adverse deterioration in the economy. While US unemployment continued to rise, some early signs of stabilisation in the labour market emerged with payrolls for May showing a noticeable reduction in the pace of job losses. US housing starts fell further and new housing construction remained at a 50-year low. However, the US National Home Builders Index rose marginally in May. US retail sales fell -0.4% in April indicating consumers were still reluctant to spend. On a more encouraging note, consumer sentiment rose to its highest level since September 2008 and the Institute for Supply Management (ISM) survey showed further signs of stabilisation in the US manufacturing sector.

Japan's real GDP declined -4% for the March quarter and growth forecasts for 2009 were revised down significantly. However, recent improvements in a business confidence survey, the leading index, industrial production and consumer sentiment suggest that Japan's economy should begin to improve in late 2009. In China, a rise in the purchasing managers index (PMI) signalled China's industrial activity is expanding, while retail sales growth remained solid and fixed asset investment strengthened. However, export data remained weak. China's deflationary impulse was evident in April with the annual consumer price index (CPI) falling further to -1.5% yoy. In Europe, industrial and consumer sentiment levels remained consistent with weak activity, despite some improvement, and supported the argument for further monetary policy easing. The European Central Bank (ECB) to cut its key policy interest rate 0.25%, to a record low of 1.0%, and edged towards 'quantitative easing'. European economies remained under severe downward pressure given the slump in exports and subdued domestic demand. For the Euro-zone, real GDP contracted by -2.5% quarter-on-quarter (qoq) in the first quarter of 2009 and real activity was considerably below year-ago levels. Meanwhile, the Bank of England (BoE) left interest rates on hold at 0.5%, but increased its quantitative easing program.

**Outlook:** The global recession appears to be moderating. Monetary and fiscal easing seems to be gaining traction, pointing to a recovery commencing from later this year.

## Australian economy

**Review:** In Australia, the Reserve Bank (RBA) left the official interest rate steady at 3% citing the global improvement in

confidence and activity and the better tone in financial markets as some of the reasons for deciding to leave the cash rate on hold. Consumer sentiment fell to 88.8, reversing most of the previous month's positive gains. Despite showing some recent signs of stabilising, consumer confidence appeared to be negatively impacted by the release of the Federal Budget for 2009-10 which forecast the largest underlying deficit in the post-war period (4.9% of GDP). Housing finance surged +4.9% month-on-month (mom) in March and annual growth returned to positive territory for the first time in over a year as first-time home buyers continued to dominate the market. Australian house prices remained under downward pressure and subsequently fell for the fourth consecutive quarter in the March quarter to -6.7% yoy. Private credit growth was very soft with solid growth in housing credit. However, business and personal credit remained weak. While business sentiment is still largely lacklustre overall, signs of improvement suggest the decline in sentiment may be stabilising. Positively, labour force data for April saw a surprise fall in the unemployment rate to 5.4% from 5.7%, while employment grew marginally. However, the turnaround in employment is in contrast to April's ANZ job advertisements which declined -7.5% mom. While GDP rose in the March quarter it is likely to fall in the June and September quarters.

**Outlook:** The Australian economy is likely to remain weak or in recession ahead of a recovery from later this year and through 2010, driven by global improvement, lower interest rates and fiscal stimulus.

## International shares

**Review:** The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned +5.8% in local currencies (or +0.1% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +5.6%. In the European region, the Eurostoxx Accumulation Index returned +4.7%; while the UK FTSE 100 Accumulation Index returned +4.7%. Japan's Topix Accumulation Index returned +7.2% and China's S&P/CITIC 300 Total Return Index returned 5.0%.

**Short-term outlook [six to 12 months]:** After the recent rebound, the next few months are likely to remain volatile given the uncertainty about the strength of an economic recovery. However, global shares are likely to provide good returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 and still attractive valuations.

**Medium-term outlook [five to ten years]:** Improved dividend yields following the share slump and profit growth around nominal GDP growth will see medium-term returns from mainstream global shares of around 9% per annum on average.

## Australian shares

**Review:** The S&P/ASX 200 Accumulation Index returned 1.4% for the month. While the overall monthly performance remained in positive territory, capital raisings weighed on the market to some degree.

**Short-term outlook:** The Australian share market is likely to remain volatile over the next few months. However, shares are likely to provide solid returns on a 12-month view. Valuations are attractive and interest rates are low, and shares are likely to anticipate better economic conditions in 2010.

**Medium-term outlook:** Reflecting much higher dividend yields and reasonable growth prospects, medium-term returns of around 11% per annum are likely.

## Real Estate Investment Trusts

**Review:** The S&P/ASX Property 200 Accumulation Index returned +3.8%, outperforming the broader equity market. The month of May built on the listed property sector's strength in April, and outperformers were once again those stocks perceived to be of higher risk that had been sold off in previous months.

**Short-term outlook:** With most property stocks having recapitalised and the credit crunch fading, real estate investment trusts have probably seen the worst. They are also good value from a long-term perspective. As such they should provide solid returns over the next 12 months.

**Medium-term outlook:** Now solid yields and moderate growth prospects mean medium-term returns of around 12% per annum are likely.

## International bonds

**Review:** International bond yields rose in April as the global economy continued to demonstrate tentative signs of stabilisation. The US ten-year bond yield gained 34 basis points (bps) to 3.46% and Japan's ten-year bond yield rose 6 bps to close April at 1.49%. In the European region, Germany's ten-year bond yield increased 41 bps to 3.59%; and the UK ten-year bond yield added 25 bps to close the month at 3.75%.

**Short-term outlook:** Sovereign bond yields may fall back in the short term on the back of the uncertainty about the strength of an economic recovery and falling inflation.

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

## Australian bonds and cash

**Review:** Australian bonds yields rose sharply over May which saw the domestic yield curve steepen and the spread between

Australian and US ten-year bond yields widen to 182 bps. The yield on the Australian ten-year bond gained 71 bps to 5.28%, while the three-year bond yield rose 52 bps to 3.96%. Bank bill yields also rose. The three-month bank bill rate opened at 3.08% and closed 11 bps higher at 3.19%. Six-month bank bill yields traded similarly, opening at 3.06 and closing 16 bps higher at 3.22%. Credit spreads tightened, reflecting the improved economic outlook and reduced uncertainty.

**Short-term outlook:** Bond yields may fall back in the short term on uncertainty regarding the growth outlook and as inflation falls.

**Medium-term outlook:** Returns from local bonds over the medium-term are likely to be poor, reflecting low yields.

## Australian dollar

**Review:** The Australian dollar (A\$) pushed higher in April, rising 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 80.31US cents (up 10.8% from 72.49US cents) and JPY76.51 (up 7.1% from JPY71.46). The TWI closed the month at 63.3 (up 6.0% from 59.7).

**Short-term outlook:** The break higher in the A\$ has opened up the prospect of further gains in the A\$ over the next six months or so, on the back of the improving global growth and commodity outlook.

**Medium-term outlook:** AMP Capital expects the A\$ to be strong over the medium term, helped by strong commodity prices.

## Key financial markets

	31 May 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	26,012	1.4%	-28.9%
MSCI World (ex-Aust Accumulation/unhedged in A\$)	3,219	0.1%	-22.2%
US S&P 500 Accumulation Index	1,496	5.6%	-32.6%
Dow Jones Eurostoxx Accumulation	349	4.7%	-35.5%
UK FTSE 100 Accumulation Index	2,738	4.7%	-23.7%
Japan Topix Accumulation Index	1,098	7.2%	-34.8%
S&P/CITIC 300 Total Return Index	2,522	5.0%	-21.6%
S&P/ASX 200 Property Accum. Index	14,993	3.8%	-50.8%
UBS Global Real Estate Investors Index	712	3.6%	-49.1%
Aust 90-day bank bill yield	3.19%	+11 bps	-460 bps
Aust 10-year bond yield	5.28%	+71 bps	-125 bps
US 10-year bond yield	3.46%	+34 bps	-60 bps
A\$ in US cents	80.31	7.8%	-15.1%
Trade-weighted index	63.3	3.6%	-9.5%

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