

# Market and Economics Report



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

## Global economy

**Review:** The global economic outlook continued to deteriorate in March with the International Monetary Fund (IMF), World Bank and Organisation for Economic Co-operation and Development (OECD) all forecasting global contraction this year. This prompted further extraordinary policy action. The US Federal Reserve (Fed) reinforced its commitment to improving lending volumes and credit market conditions by pledging another US\$750 billion to buy mortgage-backed securities. The US Treasury also unveiled its Public-Private Investment Program, designed to remove toxic debt from bank balance sheets and restore financial system stability. The US economy remained weak, with the labour market deteriorating further as large job losses were recorded and the unemployment rate rose to a 25-year high of 8.5%. Although housing starts improved slightly in February, the housing and mortgage sector remained in distress as rising unemployment and falling asset prices continued to drive up delinquency and foreclosure rates. However, there were some positives outside housing. US consumer spending data for February were mildly encouraging with both personal consumption and nominal retail sales rising for the second consecutive month. The Institute for Supply Management (ISM) manufacturing survey rebounded modestly and the national activity index improved. Economic activity in Japan continued to deteriorate in March, with manufacturing conditions, business investment and retail sales weakening further. Slowing global demand saw exports plunge 49% over the year to February. Deflation emerged as a serious concern as March consumer price index (CPI) measures revealed intensifying downward pressure on prices. Despite a modest upward revision in the December quarter gross domestic product (GDP), falls in leading indicators of economic growth suggested further contraction in Japan's real GDP in the March quarter. In China, industrial production and exports continued to weaken. However, manufacturing conditions improved for the third consecutive month, fixed asset investment surprised on the upside, credit growth strengthened and retail sales remained resilient. China's annual CPI inflation was negative for the first time since 2002, with consumer prices falling 1.6% year-on-year (yoy) in February. Europe's economic downturn persisted in March with industrial production in both the Euro-zone and the UK retreating further. In the UK, growth in the industrial sector registered its largest annual decline since 1981 and house prices continued to fall. Both the European Central Bank and the Bank of England cut rates to new historic lows in March.

**Outlook:** Global conditions are likely to remain poor this year, with the global economy contracting. This should lead to falling inflation and further monetary easing in most major countries which, along with fiscal stimulus, will aid recovery later this year and/or through 2010.

## Australian economy

**Review:** Australia's economy continued to retreat with GDP falling 0.5% in the December quarter. The Reserve Bank of Australia (RBA) elected to leave interest rates on hold at 3.25% in March but cut rates to 3.0% in April. Despite an improvement in housing finance data, construction activity remained constrained. Labour conditions remained weak with unemployment now above 5%, which was reflected in relatively poor retail sales and the ninth successive monthly decline in new motor vehicle sales. Business and consumer confidence showed some signs of stabilisation, but remained historically weak.

**Outlook:** The Australian economy is likely to remain in recession for much of this year, with the global slump yet to really impact. Lower interest rates and fiscal stimulus should help prevent a deep slump and drive a recovery in 2010.

## International shares

**Review:** The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned 6.3% in local currencies (or -1.4% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned 8.8%. In the European region, the Eurostoxx Accumulation Index returned 4.1%; while the UK FTSE 100 Accumulation Index returned 3.0%. Shares in Asia were also higher as Japan's Topix Accumulation Index returned 3.4% and Chinese shares again outperformed significantly, with the S&P/CITIC 300 Total Return Index returning 16.9% for March.

**Short-term outlook [six to 12 months]:** Turmoil may continue over the next few months on uncertainty regarding the depth and duration of the global recession. However, global shares are likely to provide reasonable returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 and 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:** In line with the rally in global equities, the Australian share market sustained strong gains throughout March. The S&P/ASX 200 Accumulation Index returned 8.0% for the month as investors capitalised on attractive valuations. Shares gained on confidence with global policy stimulus and the US plan to remove banks' toxic assets, which served to improve risk appetite and contributed to strong buying pressure.

**Short-term outlook:** The Australian share market is likely to remain volatile over the next few months. However, shares should improve 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 a much higher dividend yield and reasonable growth prospects, medium-term returns of around 12% per annum are now possible.

## Listed property securities

**Review:** Despite gains in the broader equity market, the S&P/ASX Property 200 Accumulation Index was flat in March. Improved risk sentiment meant that outperformers were stocks perceived to be of higher risk which had been sold off recently. There was again notable disparity between the returns from the highest and the lowest performing stocks.

**Short-term outlook:** The next few months are likely to remain volatile due to worries about gearing levels, capital raisings and the underlying property outlook. However, listed property securities have probably seen the worst, are very good value from a long-term perspective and should benefit from lower interest rates.

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

## International bonds

**Review:** International bond yields were somewhat mixed in March. The US ten-year bond yield fell 35 basis points (bps) to 2.66%, driven by the Fed's commitment of US\$300 billion to buy long-term government bonds. In contrast, Japan's ten-year bond yield gained, up 7 bps to close the month 1.35%. In the European region, Germany's ten-year bond yield dropped 12 bps to 2.99%, while the UK ten-year bond yield fell considerably, dropping 45 bps to 3.17%.

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

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

## Australian bonds and cash

**Review:** Australian bond yields were mixed in March as a pause in domestic monetary easing countered the influence of a sizeable rally in the benchmark US bond market. This saw a widening in the spread between Australian and US ten-year bond yields. The yield on Australian ten-year bonds was flat, rising only 1 basis point to 4.44%; while the three-year bond yield opened at 3.35% and gained 12 bps to 3.47%. Bank bill yields declined further in March, though falls were less significant than those seen in previous months. The three-month bank bill rate opened at 3.16% and closed 2 bps lower at 3.14%. Six-month bank bill yields experienced a similar decline, opening at 3.09% and falling 3 bps to close at 3.06%. Credit margins remained wide reflecting ongoing liquidity and economic uncertainty.

**Short-term outlook:** Bond yields may fall further in the short term as growth and inflation fall.

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

## Australian dollar

**Review:** The Australian dollar (A\$) was stronger in March, closing the month at 69.12 US cents (up 8.5% from 63.73 US cents) and JPY68.32 (up 9.7% from JPY62.26). The trade-weighted index (TWI) closed the month at 57.4 (up 4.7% from 54.8).

**Short-term outlook:** The next six months are likely to be soft with the A\$ buffeted by local and global growth worries and falling local interest rates.

**Medium-term outlook:** The A\$ should rebound over the medium term, helped by a rebound in commodity prices.

## Key financial markets

	31 Mar 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	24,310	8.0%	-29.5%
MSCI World (ex-Aust Accumulation/unhedged in A\$)	3,058	-1.4%	-24.5%
US S&P 500 Accumulation Index	1,293	8.8%	-38.1%
Dow Jones Eurostoxx Accumulation	288	4.1%	-42.9%
UK FTSE 100 Accumulation Index	2,411	3.0%	-28.2%
Japan Topix Accumulation Index	946	3.5%	-34.8%
S&P/CITIC 300 Total Return Index	2,297	16.9%	-32.0%
S&P/ASX 200 Property Accum. Index	13,618	0.0%	-57.6%
UBS Global Real Estate Investor Index	576	2.9%	-57.9%
Aust 90-day bank bill yield	3.14%	-2 bps	-472 bps
Aust 10-year bond yield	4.44%	+1 bp	-161 bps
US 10-year bond yield	2.66%	-35 bps	-75 bps
A\$ in US cents	69.12	8.8%	-23.9%
Trade-weighted index	57.4	4.7%	-16.7%

## Contact us

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