

Weekly Market & Economic Update – week ending 19 June 2009



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

Economic data and events

Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
US – Producer price index (PPI), May	mom	+0.2%	+0.3%	↓
US – Housing starts, May	-	532,000	454,000	↔
Australia – Leading indicators, April	yoy	-2.9%	-2.7%	↓
Australia – Customs imports, April	mom	-4.0%	-2.0%	↓
US – Leading indicators, May	mom	+1.2%	+1.0%	↑

Financial markets

Indicator	Friday, 19 June 2009	Friday, 12 June 2009	Weekly change	19 June 2008	12-month change
S&P/ASX 200 Accumulation Index	26,621	27,728	-4.0%	34,763	-23.4%
S&P/ASX 200 Property Trusts	733	777	-5.7%	1,536	-52.3%
US S&P 500	921	946	-2.6%	1,343	-31.4%
Dow Jones Eurostoxx	225	233	-3.4%	336	-33.0%
UK FTSE 100	4,346	4,442	-2.2%	5,708	-23.9%
Japan TOPIX	919	951	-3.4%	1,376	-33.2%
CITIC/S&P 300 China A	2,561	2,421	+5.8%	2,299	+11.4%
MSCI (ex-Aust/in LC)	700	721	-2.9%	1,021	-31.4%
Aust 90-day bank bill yield	3.24	3.32	-8 bps	7.73	-449 bps
Aust 10-year bond yield	5.86	5.55	+31 bps	6.58	-72 bps
US 10-year bond yield	3.78	3.79	-1 bp	4.21	-43 bps
Oil – West Texas Crude	US\$69.55	US\$72.04	-3.5%	US\$131.93	-47.3%
A\$ in US cents	US\$0.8032	US\$0.8079	-0.6%	US\$0.9499	-15.4%
TWI	64.4	65.1	-1.1%	72.6	-11.3%

Major upcoming global economic releases and events

Date	Data/Event	Units*	Previous	Market Forecast
22 June	Australia – New motor-vehicle sales, May	mom	+0.9%	na
24 June	US – Durable goods orders, May	mom	+1.9%	-0.9%
25 June	US – New homes sales, May	-	352,000	360,000
26 June	US – Personal income, May	mom	+0.5%	+0.2%
26 June	US – Personal consumption, May	mom	-0.1%	+0.4%

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

Headline developments of the past week

- A clear message from the past week is that inflation is not a problem. US consumer prices fell 1.3% over the year to May, the biggest drop since 1950, and Eurozone inflation came in at zero over the last 12 months. With US industrial capacity utilisation at a record low, a further fall in US inflation is assured. Prices are also falling in Japan and China. Against this backdrop, central banks, including the US Federal Reserve (Fed) and the Reserve Bank of Australia (RBA), will not be rushing to raise interest rates anytime soon.
- US President Barack Obama proposed a sweeping re-regulation of the US financial system. After the debacle of the last two years this was inevitable and clearly warranted in the case of the US. The regulation of the Australian financial system has been far stronger. Therefore, similar reforms in Australia are probably unwarranted, although increased regulation is likely to be a feature here too.

Major global economic releases and implications

- While US economic data was mixed, forward-looking indicators remain consistent with a recovery from later this year. On the negative side, industrial production fell 1.1% in May, a manufacturing survey reported a slight deterioration in conditions in June, and mortgage applications fell further. On the positive side, housing starts and permits to build new homes rose by more than expected in May and a survey of manufacturers in the Philadelphia region showed a further improvement in business conditions. Also, continuing unemployment claims fell unexpectedly and a leading index rose for the second month in a row in May.
- The Bank of Japan (BoJ) left interest rates on hold at 0.1% as expected, but upgraded its assessment of the economy noting that the Japanese economy has 'begun to stop worsening'.
- In Germany, a survey of investment analysts' economic confidence rose to a 3-year high, with similar gains across Europe.

Australian economic releases and implications

- In Australia, it was a quiet week on the data front. While dwelling commencements fell further in the March quarter, this was expected given the earlier slump in building approvals. Stronger housing finance and approvals in recent months point to an improvement in commencements from later this year. Meanwhile, the Westpac-Melbourne Institute's leading indicator rose again in April, pointing to a recovery from later this year.
- A study by the RBA highlighted that the global financial crisis has meant that banks' funding costs have not fallen as much as the cash rate has. In fact, home

owners on variable rates have recently had quite a good deal from banks as variable mortgage rates have fallen by more than the reduction in bank funding costs. The business sector has not done as well as business lending rates have fallen by less than the decline in funding costs.

Major market moves

- Share markets stalled over the week on worries that the rally in shares since March had run ahead of economic and profit fundamentals. Renewed uncertainty about the global recovery along with more capital raisings also weighed on the Australian share market.
- The return of concerns about the economic recovery helped boost the US dollar (US\$). This weighed on commodity prices and the Australian dollar (A\$).
- While Australian bond yields rose sharply over the past week, bond yields elsewhere were flat to lower.

What to watch in the week ahead?

- In the US, the Fed is expected to leave interest rates on hold but will be watched closely to see whether it steps up its purchases of Treasury bonds. This is unlikely to as the yield backup has been mainly due to improved confidence regarding the economic outlook. That said, it may signal an increase in buying mortgage backed securities and strengthen the message that policy tightening is some time away.

Outlook for markets

- Short-term worries about the impact to higher mortgage rates and oil prices, capital raisings, rising unemployment and the strength of the recovery are all likely to ensure a volatile ride for shares over the next few months. Selling shares to lock in capital losses may be an additional potential negative for Australian shares in the run up to 30 June. As such, the current correction may have further to run.
- However, the broad trend in shares is likely to remain up. Shares are still very attractive compared to low yielding cash and bonds, most investors are still underweight shares and a further improvement in economic data is likely.
- Bond yields are likely to fall in the short term as inflation continues to fall and interest rates remain low. But the medium-term return potential from bonds is very poor.
- After surging to a high of US\$0.8263 in early June, the A\$ is vulnerable to a further period of correction or consolidation as investors wait for fundamentals to catch up. However, the broad trend in the A\$ is likely to remain up on the back of strengthening commodity prices and a resurgence in carry trades. The A\$ is likely to rise to around US\$0.85 by year-end.

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