

Weekly Market & Economic Update – week ending 5 June 2009



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Economic data and events

Data/Event	Units*	Movement		Trend
		LATEST	PREVIOUS	
US – Pending home sales, April	mom	+5.3%	+3.2%	↓
Australia – Reserve Bank of Australia (RBA) cash rate decision, June	-	3.0%	3.0%	↔
Australia - Real gross domestic product (GDP), March quarter	qoq	+0.4%	-0.6% (revised from -0.5%)	↓
Australia – Retail sales, April	yoy	+6.8%	+6.3%	↔
US – Unemployment rate, May	-	+9.4%	+8.9%	↑

Financial markets

Indicator	Friday, 5 June 2009	Friday, 29 May 2009	Weekly change	5 June 2008	12-month change
S&P/ASX 200 Accumulation Index	26,852	26,012	+3.23%	35,822	-25.0%
S&P/ASX 200 Property Trusts	756	729	+3.7%	1616	-53.2%
US S&P 500	939	919	+2.2%	1404	-33.1%
Dow Jones Eurostoxx	229	228	+0.4%	357	-36.4%
UK FTSE 100	4405	4418	-0.3%	5995	-26.5%
Japan TOPIX	927	898	+3.2%	1425	-34.9%
CITIC/S&P 300 China A	2453	2300	+6.7%	2890	-15.1%
MSCI (ex-Aust/in LC)	714	701	+1.9%	1052	-32.1%
Aust 90-day bank bill yield	3.24	3.19	+5 bps	7.80	-456 bps
Aust 10-year bond yield	5.62	5.28	+34 bps	6.61	-99 bps
US 10-year bond yield	3.87	3.46	+41 bps	4.04	-17 bps
Oil – West Texas Crude	US\$68.09	US\$66.31	+2.7%	US\$127.79	-46.70
A\$ in US cents	US\$0.7891	US\$0.8031	-1.7%	US\$0.9584	-17.70
TWI	64.1	63.3	+1.3%	73.0	-12.2

Major upcoming global economic releases and events

Date	Data/Event	Units*	Previous	Market Forecast
9 June	Australia – National Australia Bank (NAB) business confidence, May	-	-14	na
10 June	Australia – Investor housing finance, April	mom	+4.7%	na
11 June	Australia – Unemployment rate, May	-	+5.8%	+5.7%
11 June	Australia – Employment rate, May	-	+27,300	-30,000
11 June	US – Retail sales, May	mom	-0.4%	+0.1%

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

Headline developments of the past week

- Australia's economy managed to defy the global recession and grow in the March quarter. A big driver of the positive outcome was also a surprisingly large 2.2% contribution to growth from trade. However, with export volumes likely to soften, national income taking a hit from the slump in export prices (which is only just now feeding through given the lagged adjustment to contract prices for coal and iron ore) and business investment likely to continue to struggle for a while, gross domestic product (GDP) is expected to turn negative again in the June and September quarters. A more sustained recovery should commence later this year as a stronger China feeds into export demand, housing construction starts to recover, the inventory cycle turns up and stronger public spending starts to kick in.

Major global economic releases and implications

- US economic data was positive. The highlights included a further increase in the Institute for Supply Management (ISM) manufacturing conditions index and a much smaller than expected fall in payroll employment. Pending home sales, construction activity in April and vehicle sales in May rose. A survey of layoffs fell to its lowest level since last September. There was also a surprise fall in the number of people on unemployment benefits. Against this though the ISM services sector conditions index rose by less than expected and applications to refinance mortgages fell. Talk that the US Federal Reserve (fed) will need to raise interest rates by year-end is misplaced and is just a knee jerk reaction to the smaller than expected loss of jobs in May. The reality is that unemployment is still pushing up towards 10% and excess productive capacity will ensure downwards pressure on inflation well into next year.
- Euro-zone unemployment rose by a greater than expected 0.3% to 9.2%. However, UK and Euro-zone business conditions surveys rose slightly more than expected in May.
- The positive news from China continued to flow with a couple of business conditions surveys remaining solid after strong gains since November.

Australian economic releases and implications

- Australian economic data was generally strong. Retail sales rose in April and are up 6.8% from levels a year ago. New home sales and building approvals rose further which is consistent with a pickup in housing construction starting to come through from later this year. A survey of manufacturers reported a solid improvement in May. Against this the trade balance for April swung back into deficit reflecting lower iron ore and coal prices and sharp falls in rural exports, gold exports, and manufactured exports, suggesting that March quarter's strength in export volumes may be reversing.

Major market moves

- After a three week period of consolidation shares broke out to new recovery highs helped along by better than

expected economic data. The Australian share market rose above the 4000 level for the first time since November last year.

- A further slide in the US dollar (US\$), rising commodity prices and expectations that Australian interest rates will remain well above those in other countries saw the Australian dollar (A\$) pushed up to a high of US\$0.8260, before a bout of profit taking and a stronger US\$ kicked in later in the week pushing it back to around US\$0.79.

What to watch in the week ahead?

- In the week ahead, the key focus is likely to be on Chinese economic data for May. Exports are likely to have remained weak and this may help keep growth in industrial production around April's growth rate of 7.3% year on year. Against this, Chinese data for retail trade and fixed asset investment is likely to remain strong and loan growth is expected to remain around 30% year-on-year (yoy). Chinese consumer prices are likely to continue to fall, providing a reminder that global deflation is more of a risk than global inflation.
- In Australia, the focus is likely to be on employment data for May which is expected to show a return to weakness after the surprising and hard to explain strength recorded in April. We expect a fall in employment of 20,000 and unemployment to rise to 5.7%. Business and consumer confidence surveys will also be released.

Outlook for markets

- While the ride going forward is likely to be less smooth than the last three months have been, shares are expected to continue heading higher. The break above key technical resistance around the 930 level for the US S&P 500 index and the 3900 level for the Australian ASX200 index are very positive. More fundamentally, shares are still very attractive compared to low yielding cash and bonds. Most investors are still underweight in shares and a further improvement in economic data is likely as we head towards an economic recovery from later this year. Our view remains that shares have embarked on a cyclical recovery that has further to run.
- Low inflation, low short-term interest rates, central bank purchases of sovereign bonds along with the still tough economic environment should help limit the upside in government bond yields in the short term and may even push them back down for a while. However, with yields being so low the medium-term return potential from bonds is very poor.
- The A\$ has run hard and fast and is probably due for a consolidation. However, its broad trend is likely to remain up on the back of strengthening commodity prices and a resurgence in carry trades. I have been looking for a run-up to US\$0.85 by year-end but this is starting to look like it might be too conservative.
- While commodity prices are also vulnerable to a short-term consolidation, the broad trend is likely to remain up on the back of a falling US\$, recovering growth particularly in China, and constrained supply.

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