Markets and Economies Update

April 2009

Global Economy

Some tentative signs of stabilisation in the global economy emerged in April. However, the IMF still cut its global growth forecast for 2009 to -1.3%. The US economy remained under significant pressure as the labour market continued to weaken with the unemployment rate rising to 8.5%. Payrolls declined 663,000 in March, with the largest losses recorded in manufacturing and professional services. However, improvement in the ISM manufacturing index, the national activity index and consumer spending and sentiment measures provided tentative signs that economic conditions may be stabilising. Tight credit conditions and the contracting labour market continued to weigh on US house prices and housing starts (which remain at a near 50-year low), however existing home sales rose 4.4% in February and the US national home builders sentiment index rose to its highest level since October. US inflation readings were mixed with the CPI falling 0.1% in March and the Fed's beige book of anecdotal evidence noting 'downward pressure on prices (due to) significant discounting'. However, price pressures remained evident in core inflation readings. The Japanese economy remained under pressure in April. Japan's Tankan survey produced a weak assessment of business conditions, particularly in terms of manufacturing. This was compounded by a further slump in industrial production, which declined 9.4% in February due to sliding export demand. However, a modest rebound in Japan's consumer confidence, albeit from a 35-year low in December, provided some optimism. China's economic growth slowed to 6.1% in the March quarter due to weaker exports, however other data indicated improved domestic growth. Industrial production bounced sharply, up 8.3% yoy in March; fixed asset investment accelerated by 30.0% yoy, helped by fiscal stimulus measures; and the purchasing managers index recorded 52.4 in March, passing the 50 level which marks an expansion in activity. China's nominal retail sales were also reasonably strong at 14.7% yoy in March. Europe's economic downturn continued, and remained severe, however signs emerged that its intensity is beginning to moderate. A region-wide manufacturing survey appeared to stabilise, reaching a six-month high in April, and Germany's IFO business climate index also rose. The European Central Bank made only a marginal 0.25% interest rate cut, preferring to keep its policy options open, although appeared to contemplate quantitative easing. The UK economy continued to contract. Real GDP fell 1.9% in the March quarter, the weakest result in 30 years, and the UK Government reduced its growth forecasts. A survey of credit conditions by the Bank of England revealed that lending to corporations and households remains constrained.

Australian Economy

Australia's economy continued to soften in April with the RBA Governor conceding that the country is in recession. The IMF also revised Australia's 2009 real GDP growth forecast down to -1.4% yoy. Accordingly, the central bank again lowered interest rates, effecting a 0.25% reduction as an insurance against further downside risks to the Australian economy. This was in spite of 'tentative signs of stabilisation' globally and substantial fiscal and monetary policy stimulus in the past six months. Retail sales fell 2.0% in March, while private sector credit declined towards its weakest annual growth rate in nearly 15 years. Businesses and consumers have clearly become more cautious on spending and investment plans, suggesting credit growth will remain subdued. The labour market weakened in March with employment growth stalling at just 0.2% yoy and unemployment rising to a five-year high of 5.7%. Positively, consumer and business sentiment showed signs of stabilisation, though both remain negative. Conditions in Australia's manufacturing sector also marginally improved, though remain well below expansionary levels. Consumer prices appeared to moderate with the CPI rising only 2.5% yoy in the March quarter. This is the first time since September 2007 that inflation has been within the RBA's target 2% to 3% range.

International Shares

International share markets extended their gains in April with all major indices moving higher over the month. Share markets were encouraged by an apparent moderation in the pace of economic contraction. The release of some better than expected earnings reports was also positive for investor sentiment. However, caution was the underlying theme as economic data remained weak and banking sector concerns persisted, with the US Government's stress tests indicating that some US banks may require additional capital. The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned 10.5% in local currencies (or 5.2% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned 9.7%. In the European region, the Eurostoxx Accumulation Index returned 15.9%; while the UK FTSE 100 Accumulation Index returned 8.5%. Shares in Asia were also higher as Japan's Topix Accumulation Index returned 8.3% and China's S&P/CITIC 300 Total Return Index returned 4.6%.

Australian Shares

The Australian share market continued its upward movement in April, with the S&P/ASX 200 Accumulation Index returning 5.6% for the month. The domestic economy continued to contract, however the share market was encouraged by the improved tone of data releases and some ostensible signs of stabilisation. News flow remained largely poor, with companies continuing to issue profit warnings and raise additional capital. However, shares gained on confidence as further policy stimulus both domestically and globally helped to improve risk appetite and investor sentiment. The best performing sectors in April were Consumer Staples (11.9%), Consumer Discretionary (11.7%) and Industrials (7.6%). ABB Grain, Lion Nathan and Elders were the largest positive contributors to the Consumer Staples sector; while Pacific Brands and Ten Network Holdings were the strongest Consumer Discretionary performers. The poorest performing sectors were Financials ex Property (3.6%), Health Care (3.9%) and Information Technology (4.4%). Bendigo & Adelaide Bank, Tower Australia and Suncorp Metway dragged down the Financials ex Property sector; while Ramsay Health Care and Healthscope detracted particularly from the Health Care sector.

Direct Property

The slowing domestic economy continued to weigh on the commercial property market in April. Space markets weakened further and sales transaction evidence was again limited. Demand for office space remained soft with vacancy rates and incentives rising across all states, particularly in secondary locations. The retail sub-sector again came under pressure, weighed down by the weakening consumer spending environment and tendency towards budget-conscious consumption. There was little change in the industrial market; demand for space remained weak putting further downward pressure on land values and rents.

Listed Property Securities

The S&P/ASX Property 200 Accumulation Index returned 6.1%, outperforming the broader equity market. There remained a wide dispersion of returns, and outperformers in April were again those stocks perceived to be of higher risk that had been sold down in previous months. The industrial sub-sector (16.5%) was the best performer in April. Although proximity to debt covenants remained a concern, the sub-sector gained as the appetite for risk increased. Retail (6.9%) was the second best performer, helped by a strong performance from Macquarie CountryWide Trust, which gained on its ability to sell assets to reduce its gearing. The diversified sector returned 5.4% for the month, but was dragged down by Stockland, which was punished by the market following its operational update and earnings downgrade. Commercial (-1.1%) was the listed property market's weakest performer; Commonwealth Property Office Fund's -9.9% return was a major detractor.

Australian Bonds

Australian bond yields were again mixed in April as expectations of a lower domestic cash rate countered the influence of a sizeable rally in the benchmark US bond market. This saw the spread between Australian and US ten-year bond yields narrow to 145 bps. The yield on the Australian ten-year bond gained 13 bps to 4.57%. Ongoing concerns about an increase in the supply of bonds to fund the government's fiscal stimulus also put upward pressure on yields. The three-year bond yield fell 3 bps to 3.44%. The increase in yield in the ten-year came in spite of the RBA's decision to lower interest rates by 0.25%, reflecting the greater influence of events in the US bond market on longer-dated Australian bond yields during April.

Inflation-Linked Bonds

The real yield on the Commonwealth ten-year interpolated Capital Indexed Bond ended April 36 bps higher to close the month at 2.57%. Domestic bond yields increased in response to a sharp rise in US bond yields, resulting from a substantial level of issuance of US Treasuries. Inflation-linked bonds underperformed similar maturity nominal bonds over the month. The ten-year break-even inflation level fell 19 bps to 1.96%. There were further indications that the Australian Government may resume issuing inflation-linked bonds to help fund the budget deficit, with more information expected to be released in the May budget.

Cash

Bank bill yields were relatively flat in April. The RBA elected to resume its monetary easing, cutting interest rates by 0.25% in view of the ongoing contraction in the domestic economy. While some encouraging signs emerged, improving expectations about economic recovery, economic data remained negative overall, which maintained downward pressure on bank bill yields during the month. The three-month bank bill rate opened at 3.47% and closed 3 bps lower at 3.44%. Six-month bank bill yields were unchanged at the end of April from the beginning of the month, opening and closing at 3.06%. Credit margins remained wide reflecting ongoing liquidity and economic uncertainty.

International Bonds

International bond yields improved in April as the economic outlook improved in response to tentative signs of stabilisation in economic data. The US ten-year bond yield gained 46 bps to 3.12% and Japan's ten-year bond yield rose 8 bps to close April at 1.43%. In the European region, Germany's ten-year bond yield increased 19 bps to 3.18%; and the UK ten-year bond yield added 33 bps to close the month at 3.50%.

Australian Dollar

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 72.49 US cents (up 4.9% from 69.12 US cents) and JPY71.46 (up 4.6% from JPY68.32). The TWI closed the month at 59.7 (up 4.0% from 57.4). The A$ gained on improved investor sentiment and greater risk appetite as economic data both locally and globally promoted renewed confidence in an economic recovery beginning later this year. This provided a source of support for growth-oriented currencies, including the A$. Commodity prices gained on account of the liquidity boost from global stimulus spending, which was also positive for the local currency.